

# **The application of unfair contract terms legislation to consumer credit contracts**

CONSUMER LEASES AND SMALL-AMOUNT LOANS

**Consultation Paper**



Consumer Affairs Victoria

May 2008

## Preface

In September 2006, the Victorian Government announced a comprehensive response to the *Report of the Consumer Credit Review*. This supported bringing all consumer credit contracts under Part 2B of the Fair Trading Act (unfair terms in consumer contracts), following wide consultation on the application of this legislation to specific terms and providing industry with adequate lead time to amend contracts (if necessary) before Part 2B is applied.

In April 2007, Consumer Affairs Victoria published a consultation paper that identified small-amount cash loans as one of the targeted areas in which it would develop guidelines. Consumer leases have been added to this paper because they present similar issues.

Consumer Affairs Victoria is seeking feedback on the application of Part 2B to terms in small-amount-loan and consumer-lease documentation before finalising guidance on its compliance and enforcement policy in these industry segments.

### Written submissions

If you would like to provide comment, written submissions are due by **30 June 2008**.

Send submissions to

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

Or by email to [creditreview@justice.vic.gov.au](mailto:creditreview@justice.vic.gov.au)

Unless confidentiality for submissions is specifically requested, the contents of submissions may be made publicly available. Also, submissions may be subject to Freedom of Information and other laws and this should be taken into account.

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## **Background**

Consumer Affairs Victoria has surveyed the contract documentation of six providers of small-amount loans (amounts of \$1000 or less) and four lessors of consumer goods. Based on this survey, Consumer Affairs Victoria has formed preliminary views on terms in those contracts that it considers may offend Part 2B of the *Fair Trading Act 1999* (FTA).

In its review, Consumer Affairs Victoria did not consider the size of fees charged by small-amount lenders, although this is a vexed issue, particularly in the context of application and establishment fees either constituting the whole of the lender's charge for the loan or most of the lender's charge (in addition to interest). For the surveyed lenders, such fees amounted to between 20% and 77% of the cash lent, and such fees and interest amounted to between 21% and 92% of the cash lent.

Nor did Consumer Affairs Victoria consider the interest rates charged by such lenders, although, again, the rates of the lenders surveyed were between 29% and 48% pa (30% pa being the maximum rate chargeable under the *Consumer Credit (Victoria) Act 1995* for a credit contract secured by a mortgage, and 48% pa being the maximum rate otherwise).

While the dollar value of interest charged was in all cases relatively small and much lower than the application/establishment fees, high interest rates become more significant where consumers default.

Finally, in relation to small-amount loans, Consumer Affairs Victoria did not consider default charges because it is not in a position at this stage to know whether they are genuine pre-estimates of damage or are otherwise unfair.

Nevertheless, it notes that for the contracts of one of the two small-amount lenders surveyed that applied default charges, the charges (\$50 and \$100) represented 50% and 40% respectively of the loan; and that in the context of the interest rate applicable to the outstanding amount (47.5% pa), they looked disproportionate.

In relation to consumer leases, Consumer Affairs Victoria did not consider the larger issue of the fairness of terms designed to ensure that such leases were not goods leases with an option to purchase, as defined by section 10 of the *Uniform Consumer Credit Code* (under which such leases would be deemed to be sales by instalment). These terms negated any right or obligation of consumers to purchase the goods but provided or contemplated that consumers could offer to purchase the goods for a residual value (sometimes nominal), an offer that lessors could reject.

## **Purpose of the paper**

The aim of this paper is to provide a basis for discussion between interested stakeholders and Consumer Affairs Victoria on the application of Part 2B of the FTA to terms in small-amount loan contracts and consumer leases. Consumer Affairs Victoria will also convene a forum in conjunction with the industry to discuss relevant terms.

## The process from here

As announced, Consumer Affairs Victoria will use the following process to develop guidelines, scrutinise the costs and benefits of the application of unfair contract terms and implement reform, consistent with the Government Response to the Report of the Consumer Credit Review. The program involves extensive consultation with industry, consumer groups and regulators. It is indicative only. As noted in the Government Response, Victoria would prefer the application of unfair contract terms to be progressed nationally pursuant to the outcomes of the Productivity Commission's final report of its review of Australia's consumer protection framework (May 2008). The Victorian-based process will therefore need to be flexible so that other issues, such as national considerations, can be incorporated if necessary.

Date	
	Release Consultation Paper
	Finalisation of consultation schedule
	Consumer Affairs Victoria to release an issues paper to assist interested parties to comment on issues in the priority areas of small amount lending, credit cards, alternative housing finance and reverse mortgages. The issues paper will not look at the detail of specific terms in specific contracts, but would seek feedback on the types of terms that might be unfair and people's view on the principles for identifying unfair terms, particularly in areas affected by the long term nature of some contracts where more flexibility may be needed.
	Final date for comments on the issues paper. Consumer Affairs Victoria will conduct direct consultation with regulators and other interested parties during this period. Prepare Business Impact Assessment and prepare necessary legislative changes
	Release final guidelines.
Spring Sitting	If the Business Impact Statement confirms the cost/benefit analysis, put legislative change through Parliament with a target commencement date of 1 January 2009. Commence negotiations with credit providers on the changes necessary to specific terms, where these changes have not been made already.

## **About small-amount loans and consumer leases**

Small-amount cash loans and consumer leases (such as computer deals and whitegoods rentals) are two distinct credit products often utilised by low-income families and consumers. The average small-amount cash loan is for less than \$300 (not including fees, charges and interest) and is repayable within 4 to 6 weeks.

Consumers often take out this sort of loan to pay for essential, non-discretionary household expenses. By contrast, consumer leases usually run from 1 to 5 years and the total cost will almost always be far greater than the total cost of a cash loan. It is not uncommon for small-amount cash loans to spiral out of control as consumers miss payment deadlines or incur additional fees and charges.

Those who enter into a consumer lease are often confused about the nature of the agreement, especially the consequences of returning the goods early, the costs involved in updating the goods, the ability to buy the goods at the end of the lease and the difference between the cash price for the goods and the total cost under the lease.

The Report of the Consumer Credit Review released in September 2006 by the Victorian Government estimated that the size of the small-amount lending market alone was worth \$200 million annually Australia-wide. In Victoria, the market is probably between \$50 and \$100 million. There are no readily accessible figures to indicate the size of the consumer lease market, but if anything, it is likely to be just as big, if not bigger than that for small-amount cash loans.

Many people who source small-amount cash loans or consumer leases will have difficulty resolving payment problems or disputes because many providers do not currently belong to any independent dispute-resolution scheme. However, in early 2009 it will become mandatory for credit providers to belong to such a scheme.

Some small-amount cash loan arrangements that were previously outside the scope of the Consumer Credit Code are now governed by the Code, such as 'promissory note' lending. Other adjustments that will affect the small-amount cash loan market are being considered by the Ministerial Council on Consumer Affairs. These cover issues such as security over household goods and consumer information about direct debits.

### **Part A: applying unfair contract terms legislation to small-amount loans**

The terms discussed below were present in at least two of the contracts surveyed.

#### ***Default/enforcement costs***

Terms requiring consumers to pay lenders' costs occasioned by a default are not unfair. However, section 99 of the Uniform Consumer Credit Code restricts these costs to those reasonably incurred and Consumer Affairs Victoria considers that this should be set out in these terms (section 162 of the Code and s.163(3)(c) of the FTA require credit/consumer contracts to be clearly expressed). Further, it considers that terms requiring consumers to pay any or all costs as penalising them for a breach or termination of the contract are unfair (see section 32X(c) of the FTA).

### ***Conclusive evidence provisions***

Consumer Affairs Victoria considers that terms providing for lenders' certificates/statements of the amount owed, or as to any other matter, to be conclusive evidence of that fact, are unfair because they have the object or effect of limiting the evidence that consumers can lead in proceedings on the contract (see section 32X(l) of the FTA).

### ***Assignments without notice***

Section 32X(j) of the FTA refers to terms that have the object or effect of permitting lenders to assign loan contracts without consumers' consent, where that is to consumers' detriment. Consumer Affairs Victoria does not regard a right of lenders to assign loan contracts without consent as unfair (and their effect is governed by section 166 of the Uniform Consumer Credit Code). However, consumers are entitled to notice of the assignment as soon as practicable.

### ***Acknowledgements that consumers have understood the contract***

Consumer Affairs Victoria considers terms, under which consumers acknowledge that they have read *and understood* the contract, to be unfair, firstly because it cannot be known whether a consumer has, in fact, understood what the contract, or each term, means; and secondly because such terms can be used to deter consumers from subsequently asserting that a provision of the contract was not explained to them, where an explanation was required or called for (see section 32X(k) of the FTA, which refers to terms that limit consumers' rights to sue).

### ***Unlimited assignments of wages***

Some contracts included an assignment or mortgage of wages by consumers under which, upon default, lenders can require consumers' employers to pay over their wages, without limitation.

Mortgages of wages are prohibited by s.46(1) of the Uniform Consumer Credit Code. Unlimited mortgages or assignments are also unfair because they do not have any regard to the resources and needs of consumers and of any others for whom they must, or reasonably may provide. It is for this reason that the *Supreme Court (General Civil Procedure) Rules* do not allow a judgement creditor to attach more than 20% of a judgement debtor's wages.

### ***Mortgages over household property, work tools and means of transport***

In addition to, or instead of a wages assignment, several contracts examined contained mortgages over consumers' personal property, including motor vehicles; for instance:

*Contract 1* 'As continuing security for the payment of all debts, liabilities and obligations of the borrower...the applicant grants a security interest...in all of my present or after acquired personal property and proceeds therefrom, including, without limitation, the vehicle as described in Schedule A.'

*Contract 2* 'The Debtor will grant to the Credit Provider a mortgage being a Bill Of Sale over the Mortgaged Property consisting of:... Lounge Television PALSONIC 68CM; Lounge Video PHILIPS; Lounge Stereo AKAI; Lounge Video Cabinet; Dining Chairs; Bedroom Chest Of Drawers X 2; Lounge bookcase; Lounge video cabinet; Dining Table; Dining chairs; Kitchen Microwave SHARP; Bedroom chest of drawers x 2; Bedroom Digital Clock radio.'

Such mortgages cover property, the seizing of which under a judgment debt would be prohibited by section 42 of the *Supreme Court Act 1986*.

By reference to the *Bankruptcy Act 1966* and the *Bankruptcy Regulations 1996*, section 42 prohibits the seizure of the following property of the judgement debtor:

- property used in earning income, the value of which does not exceed \$2600 (as adjusted by CPI increases since 1/7/96);
- property used primarily as a means of transport, the value of which does not exceed \$5000 (as adjusted by CPI increases since 1/7/96);
- reasonably necessary household property, having regard to current social standards, but including:
  - kitchen equipment, cutlery, crockery, foodstuffs, heating equipment, cooling equipment, telephone equipment, fire detectors and extinguishers, anti-burglar devices, bedding linen, towels and other household effects to the extent that it is reasonably appropriate for the household having regard to:
    - the number and ages of its members;
    - any special health or medical needs of its members;
    - any special climatic or other factors (including geographical isolation);
    - whether the property is reasonably necessary for the functioning or servicing of the household; and
    - whether the costs of seizure, storage and sale of the property would be likely to exceed its sale price;
  - sufficient household furniture;
  - sufficient beds for the members of the household;
  - children's educational, sporting or recreational items and books;
  - one TV, stereo, radio, washing machine, clothes drier, refrigerator, freezer, generator, telephone, VCR.

In the second reading speech to the Bill that amended section 42 to include these matters (the *Judgement Debt Recovery Bill 1984*) the responsible Minister (Mr Fordham), in justifying aligning the *Supreme Court Act* with the Commonwealth's bankruptcy legislation, said: 'The law cannot tolerate a situation in which one creditor may seize and sell for his own benefit [under the *Supreme Court Act*] property of a creditor which, if the debtor were to go bankrupt, could not be seized or sold for the benefit of all his creditors'.

The policy behind these prohibitions is to protect basic living standards of bankrupts/judgement debtors. In the same way, Consumer Affairs Victoria considers

it unfair for lenders to take mortgages over property (and potentially to seize and sell that property) that they could not seize and sell to satisfy a judgement debt.

The Ministerial Council on Consumer Affairs has recommended that the Uniform Consumer Credit Code be amended to align it with the Commonwealth's bankruptcy legislation, and the necessary amendments have been prepared.

### ***Powers of entry without consent***

For those lenders that take mortgages over consumers' goods to secure payment of the debt, the contracts usually included powers to enter consumers' premises and seize the mortgaged goods upon default; for instance:

*Contract 1*     '*Subject to law, should the Debtor default in the performance of any obligations under this Loan Contract, the Credit Provider may after service of any notice required by law at any time and from time to time:*

*(a) take possession of the Mortgaged Property....'*

*Contract 2*     '*Should I not pay that which is due immediately to [the lender] its agents may take possession of the mortgaged goods....'*

The Uniform Consumer Credit Code provides that, in the absence of a court order, consumers' written consent to enter their residential premises must be obtained before the exercise of any right to enter. Further, the Code provides for notice of default, so that no amounts can be due 'immediately'. References to 'subject to law' are insufficient to alert consumers to these rights, and the provisions of the Code should be 'signposted'. Even if the Code did not apply to a contract, Consumer Affairs Victoria would regard a power of entry without such basic limitations as unfair and as encouraging potentially dangerous and intimidating 'self-help' remedies by lenders.

### ***Powers of sale of mortgaged goods***

Contracts with goods mortgages also contained powers for lenders to sell mortgaged goods after their seizure; for instance:

*Contract 1*     '*Subject to law, should the Debtor default in the performance of any obligations under this Loan Contract, the Credit Provider may after service of any notice required by law at any time and from time to time:*

*(a) take possession of the Mortgaged Property; and*

*(b) sell the Mortgaged Property on such terms and conditions as thought fit by the Credit Provider and permitted by law, and/or apply it or any proceeds to the Debtor's account.'*

*Contract 2*     '*Should I not pay that which is due immediately to [the lender] its agents may take possession of the mortgaged goods and sell the goods and do anything else as mortgagee of the goods subject to the law.'*

The Uniform Consumer Credit Code requires lenders to sell at the best price reasonably available. References to 'subject to law' are insufficient to alert consumers to these rights, and the provisions of the Code should be 'signposted'.

Even if the Code did not apply to a contract, Consumer Affairs Victoria would regard a power of sale without such a requirement as unfair. A similar obligation - to act in good faith, having regard to the interests of the mortgagor - is imposed on mortgagees of real estate under the *Transfer of Land Act 1958*.

### ***Accounting to consumers for sales of mortgaged goods***

None of the contracts containing powers of sale of mortgaged goods required lenders to provide consumers with a report of the outcome of the sale. The Uniform Consumer Credit Code requires lenders to provide a notice to consumers stating the gross amount of sale proceeds, the lender's sale costs and the net proceeds. Consumer Affairs Victoria also considers that powers of sale are unfair without such an obligation.

### ***Unlimited assignments of insurance proceeds***

To further secure payment of any debt, some contracts contained assignments or mortgages by the consumer of the proceeds of any claim on insurance policies covering the mortgaged goods; for instance:

*Contract 1* 'The Debtor will grant to the Credit Provider a mortgage being a Bill Of Sale over the Mortgaged Property consisting of:  
(b) Any payments made or payable by an insurer to the Debtor relating to the Goods (if any).'

*Contract 2* 'The Debtor agrees to:  
(e) Pay or cause any insurer to pay, to the Credit Provider, any and all-sums of any nature received, or receivable, by the Debtor from any such insurer [of the mortgaged goods] whether being proceeds of insurance claims, refunds, bonuses or other payment whatsoever.'

These terms required payment of insurance proceeds whether or not consumers were in default under the contract and regardless of whether the proceeds exceeded any amount owing. Consumer Affairs Victoria considers it unfair to require payment of such proceeds where consumers are not in default, or to require payment of amounts more than that which is owed.

### ***Unilateral variation powers***

Some of the contracts contained powers for lenders to vary the terms without consumers' consent; for instance:

*Contract 1* 'Subject to the requirements of any law, the Credit Provider may change any terms and conditions of this Loan Contract without the consent of the Debtor. The Credit Provider will comply with all and any notice requirements required by law in advising the Debtor of any changes under this clause.'

*Contract 2* 'The Credit Provider may without the Debtor's consent change the frequency, time for payment, method of payment, and number of repayments under this Loan Contract. The Credit Provider may also without the Debtor's consent change a fee or charge or introduce new

*fees or charges. Any such change will be notified to the Debtor in writing according to the provisions of this Loan Contract.'*

Among other things, Division 1 of Part 4 of the Uniform Consumer Credit Code requires lenders to give notice, usually 20 days, of changes made to the contract pursuant to a unilateral variation power, and prohibits unilateral changes during periods of fixed interest that increase consumers' liabilities.

Beyond these procedural matters, Part 2B of the FTA operates on the substance of unilateral variation powers. As set out in its published Guidelines on unfair terms (*Preventing Unfair terms in Consumer Contracts – Guidelines on unfair terms in consumer contracts*) Consumer Affairs Victoria recognises that in long-term and ongoing contracts, lenders may have legitimate needs to be able change terms to keep abreast of dynamic market conditions. However, fairness requires that consumers be given the right to cancel the contract without penalty where the change is materially detrimental.

Consumer Affairs Victoria considers that any increase in interest rates, fees or charges, or in the frequency/number of repayments, is prima facie materially detrimental.

## **Part B: applying unfair contract terms legislation to consumer leases**

The terms discussed below were present in at least two of the leases surveyed.

### ***Default interest rates higher than under Penalty Interest Rates Act***

As set out in its *Preventing Unfair terms in Consumer Contracts – Guidelines on unfair terms in consumer contracts*, the view of Consumer Affairs Victoria on default interest rates is that 'consistent with the Government's *Fair Payments* procurement policy, which applies to its purchases from private industry, prima facie, the fair interest rate is the rate published from time to time under the *Penalty Interest Rates Act 1983* or any lower rate'. That rate is also used for judgment debts and is based on an appropriate institutional rate plus a penalty element. Since 1 October 2006, it has been 12% pa.

Some leases had default rates of 18% pa or more, and one had an additional 'late charge' fee of 10% of the overdue amount. Prima facie, such terms impose common law penalties for breach of the contract, or have the object or effect of penalising consumers for a breach of the contract (see section 32X(c) FTA). They require justification as genuine pre-estimates of the loss that lessors would suffer from default.

Further, while section 28 of the Uniform Consumer Credit Code, which regulates the imposition of default interest rates, does not apply to consumer leases, Consumer Affairs Victoria considers that terms contrary to its provisions are unfair under Part 2B of the FTA. Section 28 sets out that default interest rates can apply only in respect of the amount in default and not to the whole of the loan, and only while the default continues.

### *Exclusion of statutory conditions ‘to the extent permitted by law’ etc*

The statutory conditions implied into relevant contracts, including consumer leases, under Part 2A of the FTA (sometimes referred to as implied warranties or statutory warranties) impose non-excludable and unlimited liability on lessors for a breach.

Most of the leases referred only obliquely to the existence of the implied conditions, and in a way that might mislead consumers into believing they did not exist; for instance:

*Contract 1* ‘Apart from terms, conditions and warranties which are implied by law and are incapable of exclusion, we give no condition, warranty or representation as to ownership, description, condition, merchantability, suitability or fitness (whether for a particular or any purpose) of the equipment, and no such term, condition or warrant will be implied.’

*Contract 2* (c) No warranties are given in relation to the Equipment or any services other than those implied by law.  
d) To the extent permitted by law, damages for breaches of warranties implied by law are limited to repair or replacement of the Equipment or the re-supply of the services.  
e) We exclude all liability for indirect or consequential damage, loss of income, loss of profit or interruption of business.’

As set out in *Preventing Unfair terms in Consumer Contracts – Guidelines on unfair terms in consumer contracts*, ‘many terms that exclude or limit a supplier’s liability for loss or damage suffered by the consumer from the supplier’s acts or omissions attempt to cater for the statutory conditions with words such as “to the extent permitted by law”, or other words that only indirectly refer to the consumer’s statutory rights.

‘Such terms are still likely to be considered by Consumer Affairs Victoria to be unfair terms having the object or effect of limiting the consumer’s right to sue the supplier for a breach of a statutory condition (see section 32X(k) FTA) because most consumers will not know what that “law” is. While such terms give the appearance of complying with the law, they signify nothing to consumers who are ignorant of their rights. They are also likely to be considered to breach section 163 FTA in that they do not clearly express the consumer’s statutory rights.

‘Consumer Affairs Victoria considers that these terms may also contravene section 12(k) FTA, which prohibits the making of a false or misleading representation concerning the existence, exclusion, or effect of any condition, warranty, guarantee, right or remedy.’ It considers that the FTA can only be complied with if there is a statement of the existence and content of the statutory conditions, for instance:

The goods come with non-excludable warranties under consumer protection legislation, such as that we are the rightful owner, the goods are reasonably fit for their purpose, are not damaged, and match any description or sample. If there is a breach of a warranty, you are entitled, at your option, to cancel the lease and obtain a refund, or to have the equipment/goods repaired or replaced, and to compensation for any other loss. These statutory warranties are separate from any manufacturer’s warranty. In addition to the

statutory warranties and in addition to any manufacturer's warranty, the Trade Practices Act requires the manufacturer or importer to compensate you for any loss if the goods are, for example, not reasonably fit for their purpose. You have the option of seeking compensation from the manufacturer/importer or from us.

### ***Obligations to continue to pay rent even where goods unusable***

Most leases required consumers to continue to pay rental even if the goods became unusable for a cause not of their making; for instance:

*Contract 1* 'You are unconditionally bound to pay all amounts due under this Rental Agreement in full without set-off or counterclaim, and without any deduction in respect of taxes, unless prohibited by law, on any account whatsoever. This obligation continues no matter what happens, even if the Equipment is lost, stolen, damaged or destroyed, if it is defective or if you can no longer use it.'

*Contract 2* 'The client's obligation to pay rent and other amounts due under this agreement is unconditional for the whole of the term of this agreement, even if the equipment is damaged or destroyed, is defective or breaks down or any other thing happens in relation to it. All payments must be made without set-off, deductions or withholdings on any account.'

Consumer Affairs Victoria considers that these terms are too wide and cover situations where the goods have become unusable due to lessors' acts or omissions (including a breach of a statutory condition) or for causes outside consumers' reasonable control. It considers it unfair to require consumers to continue to pay rental other than when the goods have become unusable because of their acts or omissions.

In relation to force majeure, it is considered fairer for lessors to bear the risk/loss, as they are in a better position than consumers, and consumers should not be lessors' insurers in this regard.

### ***Consumers' liability for loss of goods or for damage to or by goods***

Most leases also provided for consumers to be liable for loss of or damage to the leased goods and for damage caused to others by the goods. However, there were no exceptions for loss or damage arising from lessors' acts or omissions, including a breach of a statutory condition, or from causes outside consumers' reasonable control. Some leases also did not exclude loss or damage to the leased goods caused by fair wear and tear.

Consumer Affairs Victoria considers it unfair to make consumers liable for loss or damage other than that which arises because of their acts or omissions. In relation to force majeure, it is considered fairer for lessors to bear the risk/loss, as they are in a better position than consumers, and consumers should not be lessors' insurers in this regard. It also considers it unfair to fail to exclude loss or damage to the leased goods caused by fair wear and tear.

### ***Set-offs***

The two terms above also prohibit set-off. As set out in its *Preventing Unfair terms in Consumer Contracts – Guidelines on unfair terms in consumer contracts*, Consumer Affairs Victoria considers that terms requiring consumers to pay without deduction or set-off are unfair (particularly where lessors hold direct debit authorities). Adequate allowance should be made for amounts that are genuinely in dispute and for a proper dispute-resolution process, including holding disputed amounts in trust or suspending the right to debit the disputed amount pending the outcome of the dispute-resolution process.

### ***Powers to direct-debit default costs etc without notice***

Several leases empowered lessors to activate direct debit authorities for other than rental payments, without notice to consumers.

Consumer Affairs Victoria considers it unfair to activate direct debit authorities, without notice to consumers, for amounts not specified in the lease, particularly if they might be disputed, such as damages or default/enforcement costs. Consumers should be given reasonable notice of the intention to debit such amounts, to enable them to raise any genuine dispute about liability or quantum (and to cancel the direct debit authority if the dispute is not resolved) or to ensure that there is sufficient money in their account (and so to avoid dishonour fees).

### ***Early termination fees***

All leases required consumers to pay a fee upon the early termination of the lease, whether by the consumer or the lessor, (called 'early termination fee', 'recoverable amount' or 'termination amount'). Aside from requirements to pay amounts owing at the date of termination (including default interest) and the costs of recovering the leased goods, all fees were primarily intended to recoup the profit that lessors would have made if the lease had gone its term.

Two fees required the payment of all future rent; one required the payment of the lesser of 95% of the future rent, or 12 or 6 or 3 months rent (depending on the type of lease in question); and one required the payment of rent until the goods were re-leased, with a maximum amount payable of 4 weeks rent.

One of these fees discounted the future rent to its present value at the Reserve Bank's cash rate; the other at '(a) the rate which is 2% less than the interest rate implicit in this agreement; and (b) the rate at which the owner can reinvest the amount received for a term ending as near as possible to the expiry of the original Term of the agreement'. One of the fees did not require the future rent to be discounted to its present value (although this was required in relation to *business* leases). The other fee did not appear to involve the payment of future rent.

Only one of the leases set out lessors' obligation to mitigate their loss by selling or re-leasing the goods, or by deducting the fair market value of the goods. None of the leases required a deduction for administration and other costs lessors would have incurred if the lease had run its term nor required lessors to account to consumers for the calculation of the fee required to be paid.

In its *Preventing Unfair terms in Consumer Contracts – Guidelines on unfair terms in consumer contracts*, Consumer Affairs Victoria sets out its general views that a requirement to pay an early termination fee unrelated to the reasonable costs reasonably incurred by the supplier from the early termination is unfair, as is a requirement to pay all of the supplier's costs and expenses arising from a breach or early termination (not just its net costs).

Where a fee based on profit-recovery (as distinct from a fee based only on wasted costs) is appropriate, Consumer Affairs Victoria considers that it should consist only of lost *net* profit. Therefore, a fee that simply requires the paying out of the remainder of the lease (sometimes called an accelerated payment clause) will invariably be unfair because it represents the lessor's *gross* profit. Further:

- the future rent component should be discounted to its present value at a transparent and fair rate;
- the costs that would have been incurred in performing the remainder of the contract, or a fair estimate, should be deducted;
- lessors' obligation to take reasonable steps to mitigate its loss by selling or re-leasing the goods should be stated, and the obligation should be to obtain the best price reasonably available (which is the standard under the Uniform Consumer Credit Code for mortgagee sales); alternatively lessors should be obliged to deduct the fair market value of the goods.

Finally, lessors should account to consumers for the calculation of the fee required to be paid.

### ***Termination for default***

All leases contained terms allowing lessors to terminate the lease immediately for non-payment of rent or other amounts, for instance:

*Contract 1*     '*In addition, if you are overdue with your payment:  
... (c) we may terminate the Contract and re-take possession of the Goods.*'

*Contract 2*     '*You will be considered to be in default and to have repudiated this Rental Agreement if you:  
(a) do not pay in full any Total Monthly Rental Payment or any other amounts due in accordance with Clause 5.*'

Further, none of the leases required lessors to give reasonable notice to remedy a remediable breach and some explicitly excluded such a requirement; for instance:

*'We may choose to give you an opportunity to remedy your breach. If you are given opportunity to remedy your breach but do not do so to our reasonable satisfaction, we may terminate the Contract. We are not obliged to give you an opportunity to remedy your breach.  
Unless we are in breach of a condition implied by legislation you must not terminate the Contract for breach by us without first giving us written notice of the breach which allows us a reasonable opportunity to remedy the breach.'*

Consumer Affairs Victoria considers it unfair to deem an overdue payment to be a repudiation of the lease or that a non-payment should otherwise entitle immediate termination of the lease, particularly where consumers must also pay an early termination fee.

It considers that this amounts to permitting lessors unilaterally to determine whether the lease has been breached (see section 32X(h) FTA). A non-payment might only be as to a small portion of the amount due, which would not normally indicate repudiation of the lease. Even a non-payment of the full amount due would not necessarily indicate repudiation. Such non-payments could be due to temporary financial difficulties or to simple oversight.

The basic common law position is that an obligation to pay rent is not, by itself, a fundamental term having the effect that any breach, however slight, entitles the lessor to terminate the lease and to recover loss-of-bargain damages (eg, the above types of early termination fees); and that where a lessor exercises a right to terminate for a breach of a non-fundamental term, it cannot recover loss-of-bargain damages, only the damages that flow from the breach..

Although it is permissible, in the commercial (B2B) context, for parties to agree that any breach is fundamental, or otherwise entitles termination and loss-of-bargain damages, it is unfair in the consumer context, and the basic common law situation should prevail.

Consumer Affairs Victoria considers that the fair approach is that:

- where the breach is **serious and irremediable**, immediate termination is not unfair, although consumers should be given 30 days notice of the intention to repossess the goods (reflecting the Uniform Consumer Credit Code);
- where the breach is **minor but irremediable**, termination (immediate or otherwise) is unfair unless for repeated such breaches and only where consumers have been notified of the breach/es and warned that repetition will entail termination (any notice of termination should include 30 days' notice of the intention to repossess the goods);
- where the breach is **remediable**, immediate termination is unfair, whether the breach is serious or minor; consumers should be given reasonable notice to remedy the breach before termination (any notice of termination should include 30 days' notice of the intention to repossess the goods).

### ***Automatic renewals***

Some leases provided for automatic renewal of the lease, either on a periodic basis, or for another fixed term, or both; for instance:

*Contract 1*     *'If you do not:*  
*(a) return the Goods to us; or*  
*(b) reach agreement with us for a new Lease Period at a mutually agreed rental; or*  
*(c) make us a written offer to purchase the Goods and we accept your offer,*  
*you will be taken to have agreed to continue hiring the Goods for a fixed term of one Charge Period and then from Charge Period to*

*Charge Period at rent equal to the Periodic Charge as defined in the Lease Schedule payable for the last Charge Period of this Contract and otherwise on the Terms and Conditions of this Contract, so far as applicable.'*

*Contract 2 [T]his agreement will be automatically renewed following the expiration of the initial term set out above for a further term equal to the lesser of that initial term or 3 months (and otherwise on the terms of this agreement) unless the client:*  
*(a) notifies the owner in writing not less than 30 days nor more than 180 days before the expiration of the initial term of the client's intention to terminate this agreement on the expiration of that initial term; and*  
*(b) returns the equipment to the owner on the expiration of that initial term. The provisions of this [term] shall also apply after the expiration of each such period of renewal.'*

Consumer Affairs Victoria considers it unfair for consumers to have to 'opt out' of renewing the lease, particularly where it must be done in a certain way at a certain time. The basic position should be that the lease terminates on the day it expires; terms such as the above effectively permit lessors but not consumers to renew the lease (see section 32X(e) FTA).

Fairness requires that consumers be able to make a positive election to renew the contract, ie to opt in. This can be done at the outset of the contract, but the choice needs to be active and very clear between automatic renewal or allowing the contract to terminate on its expiry date. A two-way tick box could be used for this purpose. If a consumer chooses to allow the contract to terminate on its expiry date, the supplier can, of course, offer a renewal to the consumer at a later date. If the election is not made at the outset, it must be provided to consumers towards the end of the contract by notice. If a consumer does not respond, the contract should terminate on its expiry date.

***Powers of entry without consent/assignment without notice/unilateral variation powers /default-enforcement costs/acknowledgements by consumers that have understood the contract***

All leases contained terms that permitted lessors to enter consumers' premises to repossess the leased goods without the need for consent or notice. Most required consumers to pay lessors' default/enforcement costs without limitation to reasonable costs reasonably incurred. Some enabled lessors to assign the lease without notice to consumers; some enabled lessors to make unilateral changes to the lease without the right for consumers to cancel without penalty where a change was materially detrimental; and some required consumers to acknowledge that they had read *and understood* the lease.

The comments above In Part A on the analogous terms in small-amount loans also apply here. In relation to repossession, the provisions of the Uniform Consumer Credit Code relating to entry to residential premises apply to the enforcement of consumer leases (see s.155).