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# Consumer leases and consumer protection: Regulatory arbitrage and consumer harm

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*Consumer leases are regulated in Australia separately from credit contracts. This has created opportunities for regulatory arbitrage and has resulted in significant harm to consumers. Recent reforms, which commenced on 1 March 2013, have addressed this problem by applying to consumer leases many of the statutory protections available to consumers under credit contracts. However, the distinction between consumer leases and credit contracts has been retained. We argue in this article that that distinction is artificial and should be abandoned. We also examine how the uneven regulation of consumer leases and credit contracts has harmed consumers and we assess the recent reforms to the regulation of consumer leases. Finally, we investigate the practice of consumer leasing in Australia by reference to our survey of the consumer leasing industry, the cost of consumer leases, and selected “real life” case studies.*

## INTRODUCTION

Consumer leases are increasingly being marketed in Australia to low-income consumers, whose limited access to credit and limited savings make it difficult to purchase goods outright, as alternatives to credit cards and other mainstream credit products.<sup>1</sup> A “consumer lease” is a bailment-for-reward or lease of goods for consumer purposes. These consumer leases allow the consumer to take immediate possession of goods without having to pay the full purchase price upfront. Yet that seemingly benign result has not been without significant problems for consumers. Until recently, a consumer who entered into a consumer lease often had a much lower level of protection under Australia’s consumer credit laws compared, for example, to a consumer who purchased the same goods using a credit card. Consumers who leased goods might, as a result of this, not understand that they could end up paying considerably more than the cash price for the goods but without ever becoming the owner of the goods.

The growth in consumer leases in Australia and in other English law-based markets is generally attributable to the presence of the following factors.<sup>2</sup> Consumer leases are attractive to consumers because they enable consumers, who are on low incomes and have limited access to credit, to acquire immediately the possession of goods that they cannot afford to purchase. Consumer leases are also attractive to lessors. They allow lessors to generate a profit on the leased goods, often substantially in excess of the cash price for the goods, by effectively financing the consumer’s use of the goods without having to comply with the regulatory obligations imposed on consumer credit contracts. In addition, a consumer lease reserves ownership of the leased goods to the lessor, thus giving the lessor

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<sup>1</sup> See Revised Explanatory Memorandum, *Consumer Credit Legislation Amendment (Enhancements) Bill 2012*, p 117 [9.30] (Revised EM).

<sup>2</sup> See Burke JJA and Cannel JM, “Leases of Personal Property: A Project for Consumer Protection” (1991) 28 Harv J on Legis 115 at 116.

“security” for the performance of the consumer’s obligations under the lease, while, depending on the design of the lease, passing on to the consumer most or all of the risks of ownership.

There are two possible regulatory classifications for consumer leases under Australia’s consumer credit laws: “consumer leases” and “credit contracts”. Dealings between a consumer and lessor which fell within the first of these categories were, until very recently, subject to considerably lighter regulation than dealings that fell within the second category. This inconsistent regulation of “consumer leases” and “credit contracts” created significant opportunities for regulatory arbitrage.<sup>3</sup>

Regulation arbitrage is:

the manipulation of the structure of a deal to take advantage of a gap between the economic substance of a transaction and its regulatory treatment.<sup>4</sup>

There was thus an ample incentive for enterprising or opportunistic lessors to enter into arrangements with consumers that were in substance credit contracts but which, because of how the contract of lease was designed, were regulated only as “consumer leases” or even not at all.<sup>5</sup> This disparity between the form and substance of the lease also created an environment in which consumers were unclear as to what rights they had in respect of the leased goods – and this has, in fact, led to numerous instances of lessors actively misleading consumers about whether they would obtain ownership of the goods at the end of the lease.<sup>6</sup> Moreover, lessors, that found even the lower level of regulation imposed on “consumer leases” too onerous, could remove their dealings with consumers from the ambit of Australia’s consumer credit laws through the simple expedient of ensuring that their leases were either for a very short term or for an indefinite term.

This article discusses the regulatory treatment of consumer leases in Australia and the harm to consumers arising from the uneven regulation of consumer leases and credit contracts. The article also, as part of that discussion, examines the elements of Phase Two of the National Consumer Credit Protection Reforms designed to “[r]educe the risk of regulatory arbitrage and avoidance mechanisms”.<sup>7</sup> The first major step towards combatting regulatory arbitrage came into effect on 1 March 2013 as part of a package of reforms to Australia’s consumer credit laws designed to enhance the regulation of potentially harmful consumer products such as consumer leases.

Part two of this article discusses the salient features of the regulatory framework governing consumer leases in Australia. We first examine the regulatory classification of consumer leases. This determines which of two regulated categories a consumer lease will fall into and has, because of the very different level of obligations imposed before 1 March 2013 by each category on the providers of consumer leases, created significant opportunities for regulatory arbitrage. This regulatory classification has so far survived the reforms intact.

Part three of this article considers the reforms introduced by the *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth) (Enhancements Act), which came into force on 1 March 2013, as these reforms are explicitly intended to ensure greater regulatory consistency between the two regulated categories of consumer lease and thus constrain regulatory arbitrage.<sup>8</sup> We review those reforms and contrast the pre- and post-Enhancements Act regulation of consumer leases. Part three also reviews the *National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012* (Cth) (Reform Bill), in which further measures to combat regulatory arbitrage are proposed.

Part four presents the results of our review of selected “real life” case studies involving consumer leases, examines examples of regulatory arbitrage in Australia and discusses the cost of consumer leases.

<sup>3</sup> Duggan AJ and Lanyon EV, *Consumer Credit Law* (Butterworths, Sydney, 1999) p 511; Revised EM, n 1, pp 108-109 [9.8].

<sup>4</sup> Fleischer V, “Regulatory Arbitrage” (2010) 89 Tex L Rev 227 at 230.

<sup>5</sup> Revised EM, n 1, pp 259-260 [11.70].

<sup>6</sup> Revised EM, n 1, pp 108-109 [9.8]. See also the results of our review of selected case-files in part four of this article, “Consumer leases in practice”.

<sup>7</sup> Revised EM, n 1, p 212 [10.43].

<sup>8</sup> Revised EM, n 1, pp 5, 80-81 [6.10], 108-109 [9.8]-[9.9], 212 [10.43] and 259-260 [11.70].

## THE REGULATORY CLASSIFICATION OF CONSUMER LEASES

Consumer leases are principally regulated by three, interlocking legislative instruments: the *National Consumer Credit Protection Act 2009* (Cth) (NCCP Act); the *National Consumer Credit Code* (which is contained in Sch 1 of the NCCP Act) (Credit Code); and the *National Consumer Credit Protection Regulations 2010* (Cth) (NCCP Regulations).<sup>9</sup> These instruments are administered by the Australian Securities and Investments Commission (ASIC).<sup>10</sup>

It is critically important to situating consumer leases in their proper regulatory context to differentiate between the commonly used label “consumer lease”, which is capable of being applied to any lease of goods for consumer purposes, and the defined term “*consumer lease*”,<sup>11</sup> as used in the NCCP Act, Credit Code and NCCP Regulations,<sup>12</sup> which applies to a significantly narrower category of leases. However, while those three instruments do not regulate all consumer leases as *consumer leases*, the instruments can still apply to consumer leases that do not come within that defined term. The different regulatory status of leases that fall within and those that fall outside that defined term – yet are both being capable of described and marketed as consumer leases – has likely contributed to the consumer harm discussed in this article.<sup>13</sup>

### Two regulated categories of consumer lease

The Credit Code – which contains the definition of *consumer lease* adopted by all three instruments – applies a bright-line test to consumer leases in order to determine which of two regulated categories a consumer lease falls into. This test has remained intact following the reforms introduced by the Enhancements Act, and this will also be the case should the Reform Bill be enacted in its current form. Our analysis of the complexities associated with the classification of consumer leases suggests there are grounds for considering that this classification too should be the subject of substantive reform.

If a lease of goods:

- (i) is entered into by a natural person;<sup>14</sup>
- (ii) is wholly or predominantly for a defined consumer purpose, namely “personal, domestic or household” purposes;<sup>15</sup>
- (iii) has been entered into by the lessor in the course of a business of leasing goods in Australia (or as part of or incidental to any other business carried on by the lessor in Australia);<sup>16</sup> and
- (iv) the amounts that are or may be paid by the lessee for leasing the goods, together with any other amount payable under the lease, exceed the cash price of the goods,<sup>17</sup>

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<sup>9</sup> The *Personal Property Securities Act 2009* (Cth) may also apply to consumer leases: see below nn 105-107.

<sup>10</sup> *National Consumer Credit Protection Act 2009* (Cth), s 239. The Australian Securities and Investments Commission (ASIC) also has jurisdiction over *consumer leases* and credit contracts under the *Australian Securities and Investments Commission Act 2001* (Cth): those dealings are “credit facilities” (*Australian Securities and Investments Regulations 2001* (Cth), reg 2B) and therefore fall within the definition of “financial product” under the *Australian Securities and Investments Commission Act 2001* (Cth) (s 12BAA(7)(k)).

<sup>11</sup> We have used italics to distinguish the defined term from the more general usage of the label, consumer leases.

<sup>12</sup> *National Consumer Credit Protection Act 2009* (Cth), s 5 and Credit Code, s 169.

<sup>13</sup> See eg, Revised EM, n 1, pp 80 [6.8], 108-109 [9.8], 212 and 259 [11.70].

<sup>14</sup> *National Consumer Credit Code* (Credit Code), ss 5(1)(a), 9(3) and 169. The Credit Code also potentially applies to leases entered into by strata corporations.

<sup>15</sup> Credit Code, ss 5(1)(b)(i), 9(3) and 170(1)(a). In the case of regulated leases other than *consumer leases*, the Code also potentially applies where the lease has been entered into wholly or predominantly to purchase, renovate or improve a residential investment property (s 5(1)(b)(ii)) or to refinance credit that has been provided wholly or predominantly for that purpose (s 5(1)(b)(iii)).

<sup>16</sup> Credit Code, ss 5(1)(d), 9(3) and 170(1)(c).

<sup>17</sup> Credit Code, ss 5(1)(c), 9(1) and (3), and 170(1)(b). The “cash price” is defined as the lowest price that the lessee might reasonably expect to be able to pay for the goods from a supplier of goods or, if the goods are not available for cash or are only available for cash at the same or similar price to which they would be provided on credit, the market value of the goods: Credit Code, s 204(1). See further McGill D and Wilmott L, *Annotated Consumer Credit Code* (LBC Information Services, Sydney, 1999) p 897.

then whether this lease is a *consumer lease* will be determined solely by whether the lease provides for the lessee to have a “right or obligation to purchase” the leased goods.<sup>18</sup> If the lessee has a such a right or obligation, the lease will be regulated as a *credit contract* (and subject to the same consumer protection measures that apply to other credit contracts such as credit cards and home mortgages).<sup>19</sup> If the lessee does not have that right or obligation, the lease will, instead, be regulated as a *consumer lease* under discrete provisions of the three legislative instruments that apply exclusively to consumer leases.<sup>20</sup>

This bright-line test, which divides consumer leases into *consumer leases* and credit contracts, is predicated on the view that consumer leases (or, indeed, other bailments) which contain a right or obligation to purchase are “functionally the same” as a credit contract.<sup>21</sup> The credit element of these leases is considered to be the deferment of the payment of the purchase price.<sup>22</sup> This is clear from the Credit Code’s deeming of the lease to be a “sale of the goods by instalments” and the lessor having provided credit to the lessee.<sup>23</sup> The Credit Code also explicitly recognises the amounts payable over the term of the lease as including the cost of this provision of credit.<sup>24</sup>

On the other side of the divide created by the bright-line test are leases which are presumably considered not to be “functionally the same” as credit contracts, otherwise there would seem to be no good reason why they too should not be regulated as credit contracts.<sup>25</sup> The distinction here must be that the lessee is only paying for the use of the goods during the term of the lease.<sup>26</sup> This superficially simple division of consumer leases into *consumer leases* and credit contracts, based on the presence or absence of a right or obligation to purchase the leased goods, is flawed.

A *consumer lease*, like any lease that is regulated as a credit contract, must be a lease where the amounts payable under that lease exceed the cash price of the leased goods.<sup>27</sup> This has the effect of removing from the definition of *consumer lease*, “true leases” or “operating leases” which clearly lack a credit element. This of itself is not problematic as the Credit Code and its related instruments are concerned with the regulation of consumer credit, and not leases of personal property in general. However, the excision of true leases from the definition of consumer lease necessarily raises the question as to the nature of those leases that remain within that definition.

Just as the Credit Code classifies regulated consumer leases as either credit contracts or *consumer leases*, so too can leases generally be divided into the two mutually exclusive categories of true lease and “finance lease”.<sup>28</sup> However, unlike the form-based test adopted by the Credit Code, finance leases

<sup>18</sup> Credit Code, ss 9(1) and 169.

<sup>19</sup> Credit Code, s 9(1) and s 9(3).

<sup>20</sup> Credit Code, s 169. The principal provisions are contained in *National Consumer Credit Protection Act 2009* (Cth), Pts 3.3 and 3.4, Credit Code, Pt 11 and *National Consumer Credit Protection Regulations 2010* (Cth), Pt 7.9. See also Beatty A and Smith A, *Annotated National Credit Code and Regulations* (4th ed, LexisNexis, Sydney, 2011) pp 437-438.

<sup>21</sup> Revised EM, n 1, p 80 [6.4].

<sup>22</sup> Beale H, Bridge M, Gullifer L and Lomnicka E, *The Law of Security and Title-Based Financing* (2nd ed, Oxford University Press, Oxford, 2012) p 257.

<sup>23</sup> Credit Code, s 9(1) and s 9(2). The relationship between ss 9 and 11 of the Credit Code is considered further in our discussion of hire purchase agreements and conditional sales.

<sup>24</sup> Credit Code, s 9(3)(e).

<sup>25</sup> The Revised EM either adopts this view with the distinction being the subtle difference between “same” and “similar” or contradicts itself on this point. The Revised EM, after having earlier described leases with rights or obligations to purchase as “functionally the same” and having the “same commercial outcome” as credit contracts (Revised EM, n 1, p 80 [6.4]), describes *consumer leases* as “functionally similar” to credit contracts (Revised EM, p 260 [11.70]).

<sup>26</sup> Revised EM, p 119 [9.35].

<sup>27</sup> Credit Code, s 170(1)(b).

<sup>28</sup> See Duggan and Lanyon, n 3, p 507; Abrams RM, “The Diminishing Difference between Selling and Leasing Tangible Personal Property” (1979) 24 *Vill L Rev* 706 at 706-707. The argument that follows that *consumer leases* are limited to finance leases is consistent with the view taken of the predecessor to the Credit Code, the Consumer Credit Code: Duggan and Lanyon, n 3, p 511.

are differentiated from true leases by reference not to their legal form but, instead, to their economic substance. If true leases do fall entirely outside the Credit Code then the only conclusion to be drawn is that the only leases that are potentially regulated by the Credit Code are leases that are finance leases. This inquiry into the substance of leases is not only more nuanced than the bright-line test but is arguably more consistent than that test with the rationale for the regulatory classification of consumer leases.

The presence in a lease of an obligation – or, in certain circumstances, a right – to purchase the goods will normally cause a lease to be considered a finance lease.<sup>29</sup> However, the absence of such a right or obligation will not necessarily be determinative of whether a lease is a true lease as opposed to a finance lease. Leases which do not contain a right or obligation to purchase can be just as much finance leases as leases which do contain such a right or obligation.<sup>30</sup> This calls into question the continued existence of a separate (and different) regulatory regime for *consumer leases* under the NCCP Act, Credit Code and NCCP Regulations. It also raises the question of whether it might be more efficient simply to regulate all *consumer leases* (apart from those that are true leases which seem, in any case, to be excluded from those legislative instruments) as credit contracts.

### **True leases, finance leases and consumer leases**

The above questions are founded on the economic substance of the leases that are regulated by the NCCP Act, Credit Code and NCCP Regulations.

All leases of goods, whether they are *consumer leases* or not, involve a transfer of possession or bailment of the goods by one party (the lessor) to another party (the lessee) in exchange for the lessee providing some advantage or reward, usually described as rental payments, to the lessor.<sup>31</sup> The lessor does not, however, part with title to the goods and, in the case of true leases, it is not contemplated that the lessee will acquire title. At the end of the lease, the lessor is entitled to have possession of the goods returned to it.<sup>32</sup> This also holds true for those leases that contain a right or obligation to purchase.

What differentiates a true lease from a finance lease is how the economic risks and benefits incidental to ownership of the leased goods are allocated between the lessor and the lessee.<sup>33</sup> In the case of a true lease, it is the lessor that retains, along with its title to the goods, most of the risks and benefits incidental to that ownership. True leases also have relatively short-terms compared to the “economic life” of the goods or the period during which the goods are economically usable. This is because the lessee is paying only for the temporary use of goods which are intended to be leased out afresh at the end of the lease, and, consequently, the rental payments generated by an individual true lease can be expected to fall short of the value of the leased goods.<sup>34</sup>

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<sup>29</sup> See Australian Accounting Standards Board, *AASB 117: Leases*, para 10(a) and para 10(b) (AASB 117). The difference between true leases and finance leases is one of substance and whether or not a lease that contains a right to purchase is considered a finance lease depends, in part, on the amount to be paid when exercising that right compared to the then value of the goods: AASB 117, para 10(b).

<sup>30</sup> This also makes it difficult to justify the continued presence of Credit Code, s 171(1). See our discussion of the *National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012* (Cth) (Reform Bill) in part three of this article, “Regulatory arbitrage, the Enhancements Act and the Reform Bill”.

<sup>31</sup> Duggan AJ, *Regulated Credit: The Sale Aspect* (Lawbook Co, Sydney, 1986) p 132; Palmer N, *Palmer on Bailment* (3rd ed, Sweet & Maxwell, London, 2009) pp 1124 and 1176.

<sup>32</sup> Beale et al, n 22, p 260.

<sup>33</sup> An influential determinant of this allocation of risks and benefits is the residual economic interest of the lessor in the goods at the end of the lease: AASB 117, n 29, para 7; White JJ and Summers RS, *Uniform Commercial Code* (4th ed, West Publishing, St Paul, 1995), p 721; Mallesons Stephen Jaques, *Australian Finance Law* (6th ed, Lawbook Co, Sydney, 2008), p 327. Other tests, including the allocation of depreciation costs, have been advanced: see Ihne RW, “Seeking a Meaning for ‘Meaningful Residual Value’ and the Reality of ‘Economic Realities’ – an Alternative Roadmap for Distinguishing True Leases from Security Interests” (2007) 62 *Bus Law* 1439 at 1450-1458; Hemel D, “The Economic Logic of the Lease/Loan Distinction in Bankruptcy” (2011) 120 *Yale LJ* 1492 at 1516-1529.

<sup>34</sup> Giddins P, “Rights of Ownership in Goods” in Davies I (ed), *Security Interests in Mobile Equipment* (Ashgate, Aldershot, 2002) p 97; Beale et al, n 22, p 261.

The lessor must therefore recoup the cost to it of acquiring the goods and derive its desired profit or return through multiple, successive leasing of the goods (either by renewing the lease with the existing lessee or by leasing the goods to different lessees).<sup>35</sup> The lessor, accordingly, retains a significant residual economic interest in the leased goods (as a proportion of the value<sup>36</sup> of the goods) at the end of the lease and is substantially exposed to any change in the value of the leased goods or in the market for leases of the goods.<sup>37</sup> True leases will not satisfy the baseline requirement in the Credit Code that the aggregate amounts payable under the lease must exceed the cash price of the goods and, consequently, will fall outside the definition of *consumer leases*.

In contrast, it is the lessee who, under a finance lease, bears substantially all the economic risks and benefits incidental to the ownership of the leased goods. This is despite the lessor's retention of title to the leased good, and the absence of any mechanism – a right or obligation to purchase – through which title can be passed to the lessee.<sup>38</sup> As will be seen below, a finance lease allows the lessor to recoup the cost of the goods to the lessor and its desired return while passing on to the lessee the economic incidents of ownership, in particular the risk of depreciation in the value of the goods during the term of the lease.<sup>39</sup>

Finance leases also have relatively long terms as, unlike true leases, the goods are usually leased for a major part or all of their economic life.<sup>40</sup> This is not the relatively short-term, temporary use of leased goods envisaged by a true lease but rather the use of goods until the near or complete exhaustion of their economic life.<sup>41</sup> At the end of the lease, the goods will likely have a sharply reduced value and the lessor will be left with a relatively small or even nominal, residual economic interest in the goods. Accordingly, the rental payments under a finance lease are designed to allow the lessor to recover the cost of goods (and any other costs incurred by it in connection with the goods and the lease) as well as generating the lessor's desired return.<sup>42</sup> These features of the finance lease mean that the amounts payable by the lessee will be in excess of the cash price for the goods.

The lessee, under a finance lease, has the use of the leased goods for most or all of their economic life, and therefore enjoys the same rights of use that an owner of the goods would have but without acquiring ownership of the goods.<sup>43</sup> Thus, even though the lease contains no right or obligation to purchase the goods, the lessee is in substantially the same economic position as a purchaser of goods

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<sup>35</sup> The former situation, especially where the lease provides for automatic renewal or renewal for a nominal amount and the terms of these leases collectively approach the economic life of the goods, may lead to the lease being treated as a finance lease.

<sup>36</sup> A useful measure of value is the amount for which the goods could be sold in an arm's length transaction: see eg, AASB 117, n 29, para 4.

<sup>37</sup> Malleons Stephen Jaques, n 33, p 327. A decline in the market for the leased goods may adversely affect the lessor's ability to recoup its costs and generate a profit due to not being able to lease the goods at the desired level of rent or at all. Also, a decline in the value of the goods due to factors such as "wear and tear", uninsured damage and technological obsolescence will mean reduced rental payments under subsequent leases. This will also impact the sale proceeds that the lessor will receive should it decide to sell the goods at the end of the lease. On the other hand, should there be an increase in the market for the leased goods or should the goods appreciate in value, the gains will flow to the lessor.

<sup>38</sup> Beale et al, n 22, p 261. See also AASB 117, n 29, paras 4, 7 and 8.

<sup>39</sup> Burke and Cannel, n 2 at 120-121.

<sup>40</sup> See AASB 117, n 29, para 10(c). The result is the same where a lease for a term significantly less than the economic life of the goods binds the lessee to renew, or allows the lessee by paying only a nominal amount to renew, the lease for a term covering the remainder of the goods' economic life. See further Cooper C, "Identifying a Personal Property Lease under the UCC" (1998) 49 Ohio St LJ 195 at 215-220.

<sup>41</sup> A consumer lease for an indefinite term may not just cover the economic life of the leased goods but may continue significantly beyond that time. The exclusion of these leases from the definition of *consumer lease* (Credit Code, s 171(1) – based solely on the absence in the lease of a fixed or definite term – is an anomaly which has now been addressed in the *National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012* (Cth).

<sup>42</sup> Duggan and Lanyon, n 3, p 507; Beale et al, n 22, p 261.

<sup>43</sup> Giddins, n 34, p 106.

whose deferred acquisition of ownership has been financed by the seller.<sup>44</sup> In the latter case, the deferral of the purchase price in a conditional sale constitutes the provision of credit by the seller to the purchaser in the amount of the unpaid balance of the purchase price.<sup>45</sup> Similarly, a lessor under a finance lease can be viewed as having financed the lessee's use of the goods.<sup>46</sup>

In summary, consumer leases that are true leases will not be regulated by the Credit Code as *consumer leases*. On the other hand, finance leases that do not contain a right or obligation to purchase the leased goods will be regulated as *consumer leases*, and not as credit contracts simply due to the absence of that right or obligation. The bright-line test that accomplishes this seems even more arbitrary or artificial on an examination of the leases that fall within the category of credit contracts.

### **Hire purchase agreements, conditional sales and credit contracts**

The consumer leases that are regulated as credit contracts, in common with those that are regulated as *consumer leases*, share the baseline requirements detailed above and:

- (i) confer on the lessee a right to purchase the leased goods; or
- (ii) impose on the lessee the obligation to purchase the leased goods.<sup>47</sup>

The distinction drawn by the Credit Code between "right" and "obligation" is an explicit reference to the distinction between "hire purchase agreements" and "conditional sales", both of which contain a credit element, but differ in terms of their legal form as to whether or not the "lessee"<sup>48</sup> is bound to purchase the leased goods from the lessor.<sup>49</sup> A hire purchase agreement is a lease or bailment where the lessee obtains possession of the goods in exchange for making rental payments and, at the end of the lease, can choose to return the goods to the lessor or purchase the goods by making a further payment to the lessor.<sup>50</sup> Title does not pass to the lessee until he or she exercises this right to purchase the goods. The lessee is, moreover, not bound to exercise that right but, if he or she does, the lessor will be bound to sell the goods to the lessee.<sup>51</sup>

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<sup>44</sup> The most obvious means of transferring the risks and benefits incidental to ownership to the lessee, is for the goods to be sold to the lessee (under an absolute or conditional sale), or for the lessee to be granted the right to purchase the goods on terms that render it reasonably certain that the lessee will exercise that right. Despite the absence of a contractual mechanism to vest title in the lessee, the lessor can still effectively "sell" the goods by ensuring that substantially all of the risks and benefits of owning the goods are borne by the lessee. This can be achieved by conferring on the lessee a right to renew the lease for a term that will exhaust any remainder of the economic life of the goods (and, again, on terms that make it reasonably certain that the lessee will renew the lease) or by requiring the lessee to make a payment at the end of the lease to account for any residual value that the goods have. In the latter case, the transfer of risks and benefits is made complete by applying in reduction or satisfaction of that amount any proceeds from the lessor's sale of the goods at the end of the lease: AASB 117, n 29, paras 10(c) and 11(b) and (c); Duggan and Lanyon, n 3, p 509; Giddins, n 34, pp 96 and 106; Malleons Stephen Jaques, n 33, p 327.

<sup>45</sup> Beale et al, n 22, pp 248-249.

<sup>46</sup> Beale et al, n 22, pp 261-262.

<sup>47</sup> Credit Code, s 9(1). The Credit Code does not apply to certain short-term credit contracts. When applied to consumer leases that would otherwise be credit contracts, this exemption encompasses leases of 62 days or less where the amount of fees and charges to be paid by the lessee does not exceed 5% of the aggregate amounts that are or may be payable under the lease, and the difference between those amounts and the cash price for the leased goods as a proportion of the former does not, when converted to an annual percentage rate, exceed 24%: Credit Code, s 6(1).

<sup>48</sup> We have used the language of leasing to allow for a more convenient comparison of hire purchase agreements (and conditional sales) with *consumer leases*, and because, as will be seen below, hire purchase agreements and conditional sales are both capable of being described as finance leases.

<sup>49</sup> McGill and Wilmott, n 17, pp 94-95; Beale et al, n 22, p 255.

<sup>50</sup> Duggan, n 31, p 166; Beale et al, n 22, pp 255-256.

<sup>51</sup> This must be a "true option" in the sense that the lessee must take some positive step to purchase the goods. It is this attribute that determines whether a transaction is a hire purchase agreement or a conditional sale, not the quantum of the amount that is payable following the exercise of the right. So long as some positive step is required (and which, if taken, will bind the lessor), it will not matter that the amount in question is only a nominal amount: Beale et al, n 22, p 250.

No such choice exists in the case of a conditional sale. Instead, the “lessee” is bound from the outset of a conditional sale to purchase the goods.<sup>52</sup> The lessee obtains possession of, but not title to, the goods sold with the passing of title subject to the fulfilment of a stipulated condition.<sup>53</sup> This condition is usually the payment in full of the purchase price for the goods<sup>54</sup> and, like the periodic rental payments under a hire purchase agreement, the purchase price under a conditional sale is often payable in instalments.<sup>55</sup>

In the case of a hire purchase agreement, the amount that the lessee must pay after exercising his or her right to purchase the leased goods is usually a nominal amount.<sup>56</sup> This does not, however, mean that the lessor will be delivering a windfall gain to the lessee. As with finance leases that are *consumer leases*, the lessor, under a hire purchase agreement, looks primarily to the rental payments made during the term of that agreement to recoup its costs and derive its return on the goods and not from a succession of hire purchase agreements covering the same goods (even, if at the end of the hire purchase agreement, the remaining economic life of the goods is not trivial). In addition, by dividing substantially all of the purchase price into instalments that are payable periodically over the term of the hire purchase agreement, the lessor is, in effect extending credit to the lessee to finance the payment of the purchase price.<sup>57</sup> Accordingly, the rental payments will include a charge for this provision of credit.<sup>58</sup>

The credit element is also readily discernable in the case of a conditional sale. The entire purchase price is payable over the term of the sale rather than via a single upfront payment. Again, by allowing the lessee to pay the purchase price by making periodic payments, the lessor is taken to have advanced credit to the lessee.<sup>59</sup> It can be seen from this that, regardless of their different legal form (a right to purchase versus an obligation to purchase), hire purchase agreements and conditional sales are functionally the same in that they both make credit available to a lessee to finance the lessee’s acquisition of the leased goods. Moreover, where the amount payable following the exercise of a right to purchase under a hire purchase agreement is set at a level that makes it reasonably certain, at the start of the hire purchase agreement, that the right will be exercised, that hire purchase agreement becomes functionally indistinguishable from a conditional sale.<sup>60</sup>

The Credit Code goes, as noted above, beyond explicitly recognising the credit element that is present in hire purchase agreements and conditional sales. The Credit Code does this by treating all leases which contain a right or obligation to purchase as falling into a single class of sale by instalments<sup>61</sup> with the lessee’s obligations taken to be supported by a mortgage over the leased

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<sup>52</sup> Duggan, n 31, p 183; Beale et al, n 22, p 255. Conditional sales are, like hire purchase agreements, a form of bailment-for-reward and what distinguishes a conditional sale from a hire purchase agreement is that the purchaser/lessee is bound to purchase the goods in the case of the former, while the lessee can choose whether or not to purchase the goods in the case of the latter.

<sup>53</sup> Beale et al, n 22, pp 248-249. It is the presence of this condition that distinguishes a conditional sale from an unconditional or absolute sale.

<sup>54</sup> The two most common types of conditional sale are sales by instalment and “retention of title clauses”. Many retention of title clauses stipulate conditions broader than the payment of the purchase price of the goods sold: the transfer of title may be conditional on all monies owing to the seller by the purchaser being paid (for example, the unpaid purchase price for other goods). See McCormack G, *Secured Credit under English and American Law* (Cambridge University Press, Cambridge, 2004) pp 53-54; Beale et al, n 22, p 238.

<sup>55</sup> Giddins, n 34, pp 95-96.

<sup>56</sup> Giddins, n 34, p 102; Beale et al, n 22, p 257.

<sup>57</sup> Beale et al, n 22, pp 257-258.

<sup>58</sup> Giddins, n 34, p 96.

<sup>59</sup> Beale et al, n 22, p 251.

<sup>60</sup> Beale et al, n 22, p 250.

<sup>61</sup> Credit Code, s 9(1) and s 9(3). See Duggan and Lanyon, n 3, p 511; Beatty and Smith, n 20, pp 52-53. The Credit Code provides two definitional provisions relating to the sale of goods by instalments. The first (s 9) covers contracts of lease (or hire) that are deemed to be a sale by instalments because the lease contains a right or obligation to purchase. The second (s 11) covers sales of goods where the purchase price is payable by instalments and those instalments in aggregate exceed the cash price of

goods.<sup>62</sup> The lessor is considered to have advanced the cash price for the goods to the lessee and the cost of this credit is the amount by which the total of all amounts payable under the lease exceeds that cash price.<sup>63</sup> Finally, title to the leased goods is treated as having been vested in the lessee<sup>64</sup> and the lessee is taken to have granted a mortgage over those goods to the lessor, in terms prescribed by the Credit Code, to secure the performance of the lessee's obligations to the lessor.<sup>65</sup>

The economic similarities between leases that are hire purchase agreements and conditional sales, on the one hand, and finance leases that are *consumer leases*, on the other hand, are obvious despite the latter's lack of a right or obligation to purchase.<sup>66</sup> In the case of all these instruments, it is the lessee, not the lessor, who bears substantially the entire risks and benefits incidental to the ownership of the leased goods.

The lessee under a conditional sale has agreed to purchase the goods from the lessor, meaning that, at the end of the conditional sale, the lessee will have completed his or her purchase of the goods and acquired title to them, and the lessor will have no residual economic interest in the goods.<sup>67</sup> Like any purchaser of goods the lessee bears the risk that the goods will fall in value but also takes the benefit of any increase in the goods' value. Again, as with the finance leases that are *consumer leases*, the lessor has, through the instalments payable under the conditional sale, recouped its costs in respect of the goods and obtained its desired return (which includes a charge levied for the deferment of the purchase price).<sup>68</sup>

Hire purchase agreements tend to closely resemble conditional sales economically. The level at which the amount payable on the exercise of the right to purchase is usually set means that, as is the case with finance leases that are *consumer leases* and conditional sales, the lessor is able to recoup its costs and derive its desired return substantially from the rental payments that the lessee is obligated to make during the term of the lease. In addition, it is reasonably certain that the lessee in these circumstances will exercise his or her right, and, with title passing to the lessee, the lessor will, at the end of the hire purchase agreement, retain no further residual economic interest in the goods.<sup>69</sup> The lessee, under a hire purchase agreement, is thus, at the time the right is exercisable, in no different a

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the goods: Credit Code, s 11(1). A hire purchase agreement would fall outside s 11 as it is a bailment-for-reward (whether described as a lease or contract of hire) and, in place of an absolute obligation to return the goods to the lessor at the end of the lease, the lessee has a right to purchase the goods. It is difficult, however, to distinguish a contract of lease which contains an obligation to purchase from a contract of sale by instalments as, in the case of the former, the rental payments are partial payments of the purchase price and paying the final rental payment completes the sale of the leased goods to the lessee. The difference here must therefore be one of form only – a contract expressed in terms of a lease (or hire) that contains an obligation to purchase will fall within s 9 while a contract expressed in terms of a sale by instalments will not fall within s 9: Credit Code, ss 9(1) and 11(2) and 11(4). The latter is still treated as a credit contract by the Credit Code in – subject to one exception – exactly the same terms as how a lease that is a conditional sale is treated as a credit contract: Credit Code, s 11(3). The only difference is that, for a contract of sale which falls within s 11, there is no deemed vesting of title to the goods in the purchaser and neither is the purchaser deemed to have mortgaged the goods back to the seller: Credit Code, s 9(3)(d) and s 9(3)(f). Accordingly, the exercise by the seller of any right to repossess the goods is not subject to the same restrictions as are imposed on lessors under s 9: Credit Code, s 9(3)(f).

<sup>62</sup> Credit Code, s 9(3)(f).

<sup>63</sup> Credit Code, ss 9(2) and 9(3)(b), (3)(c) and (3)(e).

<sup>64</sup> Credit Code, s 9(3)(d). Title is taken to have passed at the time of delivery of the goods to the lessee or the start of the contract, whichever is later.

<sup>65</sup> Credit Code, s 9(3)(f). The terms regulate the circumstances in which the lessor can repossess and sell the leased goods: *National Consumer Credit Protection Regulations 2010* (Cth), reg 66 and Form 4. See also n 61.

<sup>66</sup> Duggan and Lanyon, n 3, p 509; Both hire purchase agreements and conditional sales can, given the allocation of risks and benefits under them, be considered finance leases: see AASB 117, n 29, para 10(a) to para 10(c).

<sup>67</sup> See Cooper, n 40 at 211.

<sup>68</sup> AASB 117, para 10(a).

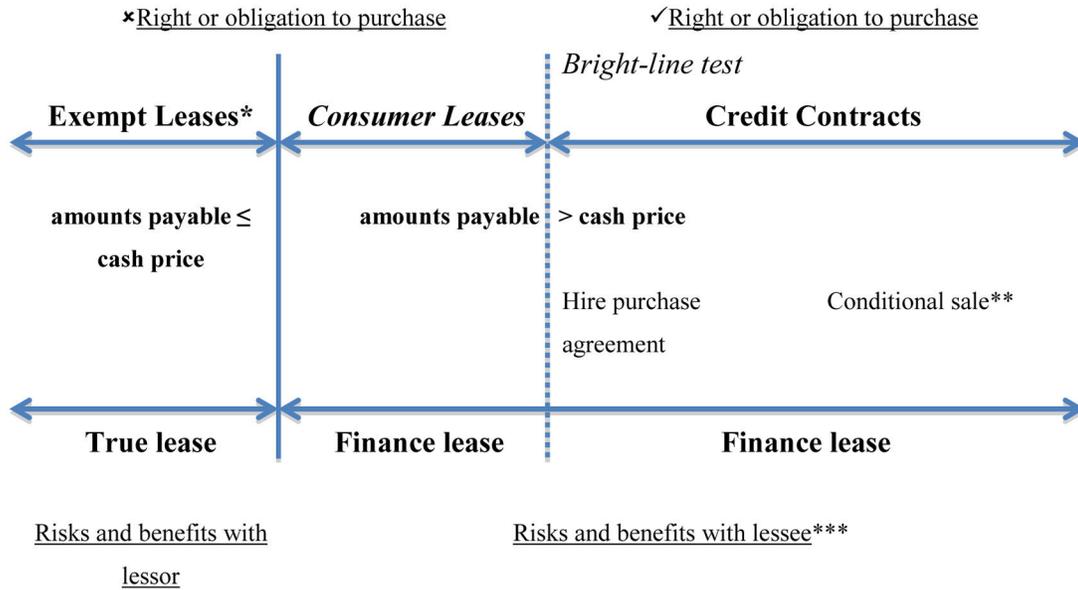
<sup>69</sup> This question is more difficult where the amount payable on the exercise of the right to purchase is a non-trivial amount. If that amount is substantially less than the then value of the goods, then it may still be reasonably certain that, at the end of the hire purchase agreement, the lessee will exercise the right and the lessor will not retake possession of the goods. The difference between the amount payable and the value of the goods means that the rental payments made during the term of the agreement

position to that of a lessee under a conditional sale at the time the last instalment of the purchase price falls due. This likely provides the rationale for the Credit Code treating hire purchase agreements as the same as conditional sales.<sup>70</sup>

Thus, where a finance lease covers a major part or the entire economic life of the leased goods (with the goods having little or only nominal value at the end of the lease), it does not matter, from the perspective of the lessee's ability to use the goods, whether the lessee only ever has possession of the goods (as is the case with those finance leases that are *consumer leases*) or acquires both title and possession (by exercising the right to purchase or paying the final instalment of the purchase price).<sup>71</sup> Likewise, from the lessor's perspective, it will have, under all three transactions, recouped its costs and generated a margin over those costs which includes a charge for the provision of credit.<sup>72</sup>

**Finance leases, consumer leases and credit contracts**

The bright-line test adopted by the Credit Code in classifying consumer leases is superficially attractive in its simplicity. Yet that test leaves us with a situation where leases that are economically very similar (if not equivalent) are regulated separately. The current regulatory classification of consumer leases can be summarised as follows.



\* There are also exemptions for very short-term leases (four months or less) and leases for an indefinite term. See footnote 41. These exemptions are discussed in part three of this article.

\*\* See footnote 61.

\*\*\* See footnote 69.

In part three of our article, we examine the extent to which the Enhancements Act has created parity of regulatory treatment between these two categories. One might wonder if a simpler and more efficient solution to the issue of regulatory arbitrage would be to regulate all consumer leases to which

by the lessee must already have accounted for substantially all of the lessor's costs and desired return. See AASB 117, n 29, para 10(b). See also Boss AH, "Leases and Sales; Ne'er or Where shall the Twain meet?" [1983] Ariz St LJ 357 at 374-375; Cooper, n 40 at 212-213.

<sup>70</sup> AASB 117, para 10(b). See also n 51.

<sup>71</sup> Beale et al, n 22, p 261.

<sup>72</sup> The lessor will also, in the case of all three transactions, have retained title to the goods during the term of the transactions. See further nn 105-107.

the Credit Code now applies as credit contracts. All the bright-line test seems to achieve is to divide arbitrarily consumer leases that are finance leases into two different regulatory categories.

### **REGULATORY ARBITRAGE, THE ENHANCEMENTS ACT AND THE REFORM BILL**

The different regulatory treatment of consumer leases, due to their being classified as credit contracts or *consumer leases* according to the simple test of whether or not the lease contains a right or obligation to purchase, has created opportunities for regulatory arbitrage. Until recently, *consumer leases* were subject to “significantly less extensive”<sup>73</sup> regulatory obligations than the corresponding obligations imposed on consumer leases that fell within the definition of credit contract. This carried potential for harm to consumers, something which has been borne out by our examination in part four of this article of the practice of consumer leasing in Australia.

A lessor has, when choosing the legal form of its consumer lease, three choices:<sup>74</sup>

- (i) A lease which is a *credit contract*. This subjects the consumer lease to the same regulatory requirements that apply to other credit contracts. These leases are not considered to be harmful to consumers in the way that *consumer leases* and exempt leases are, and are therefore not the target of the reforms introduced by the Enhancements Act or proposed by the Reform Bill.<sup>75</sup>
- (ii) A lease which is a *consumer lease*. These leases were, prior to the commencement of the Enhancements Act, subject to a much lower level of regulation than credit contracts. The potential for harm is present where a consumer, who has a reasonable expectation that he or she will, in some manner, become the owner of the leased goods at the end of the lease, enters into a lease whose legal structure is inconsistent with that expectation – due to the lessor’s rational preference for this type of lease.<sup>76</sup>

In this situation, a consumer may mistakenly believe that making rental payments, especially payments in excess of the cash price for the leased goods, may result in the acquisition of title to the goods, when that is not the case.<sup>77</sup> Likewise, a consumer may discover that he or she must continue making rental payments to the lessor in order to enjoy the continued use of the goods (even where the consumer has already paid in excess of the cash price for the goods).<sup>78</sup>

- (iii) A lease which is an *exempt lease*. True leases – that is, leases which do not contain a right or obligation to purchase and where the amounts payable under the lease do not exceed the cash price of the leased goods – are exempt from regulation under the NCCP Act, Reform Bill and NCCP Act.<sup>79</sup> A lessor that only provides exempt leases (whether true leases or not) will fall completely outside the consumer credit laws.<sup>80</sup> True leases are not considered harmful to consumers.<sup>81</sup> There are, however, two other categories of exempt lease – leases for very short terms (four months or less) and those for an indefinite term – which carry the potential for

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<sup>73</sup> Revised EM, n 1, p 116 [9.25].

<sup>74</sup> Treasury, *National Credit Reform* (Green Paper, July 2010) p 70 (Green Paper).

<sup>75</sup> The Revised EM explicitly states that these leases “do not present consumers with the problems or risk of harm that can arise in relation to consumer leases and exempt leases”: Revised EM, n 1, p 115 [9.25].

<sup>76</sup> Revised EM, n 1, pp 80 [6.5], 120-121 [9.38]-[9.39] and 129 [9.81].

<sup>77</sup> Revised EM, n 1, p 80 [6.6].

<sup>78</sup> Revised EM, n 1, p 80 [6.6].

<sup>79</sup> A lessor can also place a lease outside the two regulated categories by having the lessee declare that he or she is not leasing the goods wholly or predominantly for a consumer purpose: Credit Code, ss 13(2) and 172(2). The declaration, however, creates only a presumption which will be rebutted if, at the time of the declaration, the lessor knew, or had reason to believe, or would have known on making reasonable inquiries, that the goods were, in fact, being leased for a consumer purpose: Credit Code, ss 13(3) and 172(3). These provisions are not unique to *consumer leases* and apply to all credit contracts: Credit Code, s 13(2) and s 13(3).

<sup>80</sup> Revised EM, n 1, p 127 [9.75].

<sup>81</sup> See eg, Micah Law Centre, *A Loan in Lease Clothing* (Micah Law Centre, Melbourne, 2007) p 9.

considerable consumer harm.<sup>82</sup> They are the subject of the Reform Bill whose purpose is to subject them to the same regulatory requirements that now apply to *consumer leases*. We discuss these exemptions and the Reform Bill below.

Not all the harm that may be caused by a lessor's choice of a *consumer lease* is attributable to regulatory arbitrage alone. For example, the lessee's mistaken belief that he or she will become the owner of the leased goods may be due to the lessee's misunderstanding of the terms of the lease, the lessor not informing the lessee that ownership of the goods will not change at the end of the lease, or the lessor misrepresenting the terms of the lease to the lessee. None of these are, in isolation, instances of regulatory arbitrage although they are seen as the result of the same circumstances – the lower level of regulation of *consumer leases* compared to credit contracts – that create the opportunities for regulatory arbitrage.<sup>83</sup> Thus, this harm to consumers, particularly more vulnerable consumers on low incomes and with low levels of financial literacy, can be addressed by the same steps taken to constrain regulatory arbitrage.

Regulatory arbitrage occurs where a lease that is designed to provide the lessee with the opportunity to own the leased goods is disguised as a *consumer lease*.<sup>84</sup> In this case, the lessee may suffer harm as a result of the lesser regulatory requirements, particularly in relation to disclosure, that apply to *consumer leases*. Another, more extreme example of regulatory arbitrage is where a lease is deliberately structured to ensure that it is neither a credit contract nor a *consumer lease*, for the purpose of avoiding regulation completely.

The first step towards addressing the harm to consumers arising from regulatory arbitrage and the uneven regulation of *consumer leases* and credit contracts has recently been implemented, as part of the Enhancements Act which came into force on 1 March 2013.<sup>85</sup> The Enhancements Act extends to *consumer leases* almost all of the key consumer protection measures that already apply to credit contracts (including hire purchase agreements and conditional sales).<sup>86</sup> This is designed to ensure greater consistency of regulatory treatment between *consumer leases* and credit contracts and, consequently, reduce the opportunities for regulatory arbitrage.<sup>87</sup> The next step concerns the removal of the opportunities for regulatory arbitrage created by the exemptions under the Credit Code for very short-term leases and leases for indefinite terms.<sup>88</sup> The Reform Bill, which was released by Treasury for public consultation on 21 December 2012, contains provisions to that effect. Treasury is also considering restricting the amounts lessors can charge consumers for the early termination of a *consumer lease*, and introducing further disclosure obligations to provide consumers with a better understanding of the cost of a *consumer lease* and to assist them in comparing *consumer leases* with

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<sup>82</sup> Revised EM, n 1, pp 119 [9.37], 121 [9.45], 125-126 [9.64] and [9.68], and 128-129 [9.80].

<sup>83</sup> Revised EM, n 1, pp 118 [9.33], 119 [9.36], 121 [9.43] and 122 [9.48].

<sup>84</sup> There may also be situations where the consumer has facilitated this regulatory arbitrage. For example, it may be the clear understanding of the parties that the lessee will acquire title to the goods at the end of the lease (by making the final rental payment or some further nominal payment) but the lease terms themselves will make no reference to this. See Duggan, n 31, pp 132-133; Sykes EI and Walker S, *The Law of Securities* (5th ed, Lawbook Co, Sydney, 1993) p 548; Duggan and Lanyon, n 3, p 509.

<sup>85</sup> Revised EM, n 1, pp 129-130 [9.84]-[9.89]. See also n 8.

<sup>86</sup> Revised EM, n 1, pp 129-130 [9.85]-[9.86].

<sup>87</sup> Revised EM, n 1, pp 10 [1.8], 12 [1.15] and 80 [6.10].

<sup>88</sup> Revised EM, n 1, p 131 [9.89]. See also n 41.

alternatives.<sup>89</sup> These last proposals have been the subject of Treasury's discussions with a consumer lease working group<sup>90</sup> and, most recently, the subject of a discussion paper released for public comment in April 2013.<sup>91</sup>

### The regulation of consumer leases prior to the Enhancements Act

Even a cursory comparison of the regulatory obligations imposed on credit contracts with those imposed on *consumer leases* – prior to the commencement of the Enhancements Act – would make it clear why lessors would choose to lease goods to consumers under a *consumer lease* and not under a credit contract. A lessor could achieve for itself the same result economically under a *consumer lease* as it could under a credit contract without the added burden of having to comply with the more onerous obligations applicable to credit contracts. For example, a lease of goods for their economic life can deliver to the lessor the same return as a lease of those goods under either a hire purchase agreement or a conditional sale. Alternatively, a lessor can achieve the same result as a hire purchase agreement or conditional sale by disguising the mechanism by which the lessee acquires title to the leased goods to ensure that the lessee does not have a right or obligation to purchase the goods.

A lessor under a *consumer lease* was, prior to the commencement of the Enhancements Act, subject to few regulatory obligations beyond those dealing with licensing and general conduct imposed by the NCCP Act on any person engaging in a “credit activity” (a term which includes credit contracts as well as *consumer leases*).<sup>92</sup> A lessor is prohibited from entering into a *consumer lease* unless it holds an Australian credit licence and is subject to responsible lending obligations set out in the NCCP Act, must have an internal dispute resolution procedure for resolving disputes with its customers, and must be a member of an approved dispute resolution scheme (that is, either the Credit Ombudsman Service or the Financial Ombudsman Service).<sup>93</sup> These responsible lending provisions are designed to prevent consumers entering into unsuitable credit contracts or *consumer leases*. They prohibit a lessor from entering into a *consumer lease* with a consumer, or suggesting or assisting the consumer to enter into a lease (with another lessor) where the lease is presumed to be unsuitable for the consumer.<sup>94</sup> A lease will be presumed to be unsuitable where, for instance, the consumer will be unable to comply with his or her obligations under the lease, or will only be able to comply with substantial hardship,<sup>95</sup> and it is the lessor that has the onus of rebutting the presumptions.

An examination of the Credit Code before the Enhancements Act commenced shows the sparseness of the additional obligations imposed in relation to *consumer leases*:

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<sup>89</sup> Revised EM, n 1, p 130 [9.87].

<sup>90</sup> Treasury, *Early Termination Fees under Consumer Leases* (Consumer Lease Group Consultation, Discussion Paper, 8 August 2012); Treasury, *Extension of Disclosure Requirements Applying to Consumer Leases* (Consumer Lease Group Consultation, Discussion Paper, 18 September 2012).

<sup>91</sup> Treasury, *Changes to Disclosure Requirements under the National Consumer Protection Act 2009* (Discussion Paper, April 2013).

<sup>92</sup> *National Consumer Credit Protection Act 2009* (Cth), s 6(1).

<sup>93</sup> *National Consumer Credit Protection Act 2009* (Cth), ss 29(1), 35(1) and 47(1). See eg, the recent enforcement by ASIC of the licensing requirements against an unlicensed lessor (ASIC, *ASIC Accepts Enforceable Undertaking from Solar Rental Company* (13-090MR, 29 April 2013)) and of the responsible lending obligations against licensed lessors (ASIC, *ASIC Takes Action against Zaam Rentals, Cancelling its Licence and Banning its Directors* (13-021MR, 11 February 2013); ASIC, *ASIC Takes Action against Mobile Rentals, Cancelling its Licence and Banning its Director* (13-028, 19 February 2013)); ASIC, *ASIC Removes Mobile Rentals' Franchisees from Industry* (13-245, 3 September 2013).

<sup>94</sup> *National Consumer Credit Protection Act 2009* (Cth), ss 115(1), 123(1), 128 and 133(1) (for leases that are credit contracts), and ss 138(1), 146(1), 151 and 156(1) (for *consumer leases*). See further ASIC, *Credit Licensing: Responsible Lending Conduct*, Regulatory Guide 209 (February 2013), [209.3], [209.68] and [209.104].

<sup>95</sup> *National Consumer Credit Protection Act 2009* (Cth), ss 118(2), 123(2), 131(2) and 133(2) (for leases that are credit contracts), and ss 141(2), 146(2), 154(2) and 156(2) (for *consumer leases*). See further ASIC, Regulatory Guide 209, [209.82] and [209.84].

### ***Provisions applying to both consumer leases and credit contracts***

Specified provisions of the Credit Code which applied to credit contracts were also applied to *consumer leases*.<sup>96</sup> This was only a very limited application of the former provisions, unlike what the Enhancements Act has done in this regard. The provisions so applied related mainly to the lessee's right to have a contract varied on the grounds of hardship,<sup>97</sup> the lessor's right to demand information about the location of the leased goods and restrictions on the lessor's ability to enter on to residential property to repossess the leased goods.<sup>98</sup>

### ***Disclosure obligations***

The lessor was required to provide the lessee with a copy of the lease and an "information statement" within 14 days of the lease being entered into.<sup>99</sup> Both the lease and the information statement had to include certain prescribed information. There were three glaring flaws with these disclosure requirements.<sup>100</sup> First, these documents were only required to be provided after the lessee had entered into the lease and there was no provision for pre-contractual disclosure of the terms of the lease. This raised the prospect that key terms of a *consumer lease* might only become known to the lessee after he or she had already entered into the lease. Secondly, there was no requirement, as part of the prescribed contents of the lease and the information statement, for the lessee to be informed as to whether he or she would (or would not) become the owner of the leased goods. Thirdly, the prescribed information provided no basis on which the lessee could determine the cost of the lease relative to the cost of purchasing the leased goods up-front or compare the cost of the lease with alternatives.<sup>101</sup>

### ***Early termination of a consumer lease***

The lessee could terminate a *consumer lease* early by returning the leased goods to the lessor.<sup>102</sup> The amount to be paid by the lessee on early termination was the lesser of any early termination amount provided for in the lease and the amount determined in accordance with the NCCP Regulations (which, to date, have not prescribed any means of determining the early termination amount).<sup>103</sup> This leaves it to the lessor to determine what it should charge the lessee for terminating a lease early and creates an opportunity for windfall gains to be generated.

### ***Restrictions on the lessor's right to repossess the leased goods***

The lessor was prohibited from exercising any right to repossess the leased goods unless 30 days' prior notice had been given to the lessee.<sup>104</sup> This was subject to a number of exceptions, including the expiry of the term of the lease, the bankruptcy of the lessee and where the lessor reasonably believed that the lessee had sold or was attempting to sell the leased goods. This requirement was intended to provide a lessee a reasonable opportunity to rectify a default.

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<sup>96</sup> Credit Code (before the *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth)), s 177.

<sup>97</sup> *National Consumer Credit Protection Act 2009* (Cth) (before the *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth)), s 72.

<sup>98</sup> Credit Code, ss 98 and 99. The *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth) has retained these provisions.

<sup>99</sup> Credit Code, ss 174(1) and 175(1); *National Consumer Credit Protection Regulations 2010* (Cth) (before the *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth)), reg 105(1) and Form 17.

<sup>100</sup> Revised EM, n 1, p 119 [9.36]. See also Green Paper, n 74, pp 78-79 for a section-by-section comparison of the pre-*Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth) disclosure requirements for *consumer leases* and credit contracts.

<sup>101</sup> The prescribed information included the number, total amount and individual amount of the rental payments, the amount of other charges not included in the rental payments and the amount to be paid on early termination: Credit Code, s 174(1).

<sup>102</sup> Credit Code, s 179. The *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth) also retained this section.

<sup>103</sup> See further McGill and Wilmott, n 17, p 929.

<sup>104</sup> Credit Code, s 178. The *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth) also retained this section.

It is possible that the *Personal Property Securities Act 2009* (Cth) (PPSA) may also apply to a *consumer lease*.<sup>105</sup> The lessor's "security" under consumer leases has, traditionally, been its retention of ownership of the leased goods which confers on it a right to retake the goods on the lessee's default and priority over the lessee's other creditors if the lessee becomes bankrupt. If, however, the PPSA applies to a *consumer lease*, the lessor will be required to "perfect" its interest in the goods, in order to ensure that it enjoys a superior claim to the leased goods commensurate with its status as the owner of those goods.<sup>106</sup> The lessor may then also be required by the PPSA to exercise its rights under the lease "honestly" and "in a commercially reasonable manner".<sup>107</sup>

### **Choice of form of lease**

It is, on the basis of the above summary, unsurprising that lessors would choose to structure their leases as *consumer leases* to avoid those leases being regulated as credit contracts. Moreover, a lessor could even, by structuring its lease to fall within the exemptions for very short-term leases and leases for indefinite terms, avoid regulation altogether. The use of an exempt lease meant not only avoiding the regulations applying specifically to *consumer leases* but also avoiding the licensing and general conduct obligations. Again, it is not surprising that lessors have made use of that opportunity.

### **The regulation of consumer leases after the Enhancements Act**

The Enhancements Act provides greater regulatory consistency between *consumer leases* and credit contracts by, for the most part, applying to *consumer leases* provisions of the Credit Code that already apply to credit contracts. To the extent that new requirements have been introduced by the

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<sup>105</sup> Leases of goods, whether they are *consumer leases* or credit contracts, will be treated by the *Personal Property Securities Act 2009* (Cth) as giving rise to a security interest in respect of the leased goods, if either (a) they are a "PPS lease", which includes all leases for a term of more than one year or for an indefinite term (*Personal Property Securities Act 2009* (Cth), ss 12(3)(c) and 13(1)), or (b) they, irrespective of their term, can be characterised as creating, in substance, an interest in the leased goods for the purpose of securing the performance of the lessee's obligations to the lessor (*Personal Property Securities Act 2009* (Cth), s 12(1) and s 12(2)(d), s 12(2)(e) and s 12(2)(i)). The *Personal Property Securities Act 2009* (Cth) also brings within the definition of "PPS lease" certain leases whose terms do not exceed one year (eg, leases for more than 90 days of goods with serial numbers (*Personal Property Securities Act 2009* (Cth), s 13(3)(e)(i))). See further McCracken S, "Conceptualising the Rights of a Lessee under the Personal Property Securities Regime: The Challenge of 'New Learning' for Australian Lawyers" (2011) 34 UNSWLJ 547 at 557; Mirzai N, "The Personal Property Securities Act and Commercial Lease Agreements: A Practitioner's Guide" (2011) 22 JBFLP 3 at 5-10. A true lease that is not a PPS lease will generally not give rise to a security interest: Mirzai, n 105 at 10. A conditional sale will generally be treated as creating a security interest, and hire purchase agreements that provide only for a nominal purchase price are more likely to be treated as creating a security interest than those where the purchase price approximates the residual value of the goods. The position, however, is less clear for other finance leases: McLaren RH, *Secured Transactions in Personal Property in Canada* (2nd ed, Carswell, Scarborough, 2000), [1.02[1][a][ii]]. For conditional sales and retention of title clauses, see further Collier B, von Nessen P and Collier A, "The PPSA: Continuing the Reconceptualisation of Retention of Title (*Romalpa*) Security" (2011) 34 UNSWLJ 567; Duggan A, "Romalpa Agreements Post-PPSA" (2011) 33 Syd L Rev 645.

<sup>106</sup> A perfected security interest is one which enjoys the maximal benefits, under the *Personal Property Securities Act 2009* (Cth), of priority relative to competing claims against a common debtor: *Personal Property Securities Act 2009* (Cth), ss 32(5) and 55. The order of priorities under the *Personal Property Securities Act 2009* (Cth) can, however, be different for *consumer leases* and leases that are credit contracts: (i) if the *consumer lease* is a PPS lease or a security interest (and thus subject to the perfection requirements of the *Personal Property Securities Act 2009* (Cth)), the proceeds must be applied to discharge any obligations that have a higher priority ranking than that of the lessor (s 140(2)); (ii) if the *consumer lease* falls outside the *Personal Property Securities Act 2009* (Cth), the lessor will have the first priority that is accorded at general law to the owner of property; and (iii) if the lease is a credit contract (whether or not it is also a PPS lease or a security interest), the positions under the general law and under the *Personal Property Securities Act 2009* (Cth) both mean that it is the lessor who has first priority: Credit Code, ss 9(3)(f), 105 and 204(1); *Personal Property Securities Regulations 2010* (Cth), reg 4.1. Perfection will involve the lessor registering a financing statement giving public notice of the lease: *Personal Property Securities Act 2009* (Cth), s 21(1) and s 21(2)(a). Failure to perfect will lead to the lessor being treated as an unsecured creditor of the lessee on the lessee's bankruptcy (unless the lease is a PPS lease of goods with serial numbers and is for a term between 90 days and 1 year); ss 267 and 268(1)(a)(ii).

<sup>107</sup> *Personal Property Securities Act 2009* (Cth), s 111(1). That statutory duty and the other restrictions on the enforcement of security interests imposed by the *Personal Property Securities Act 2009* (Cth) do not apply to PPS leases that do not secure the performance of an obligation: s 109(1)(c). See further Mirzai, n 105 at 20-23.

Enhancements Act in relation to *consumer leases*, which were not already part of the Credit Code's provisions regulating credit contracts, those requirements have been applied by the Enhancements Act to both *consumer leases* and credit contracts.

We comment below on the more significant of the changes to the regulation of *consumer leases* effected by the Enhancements Act.<sup>108</sup> The first item below discusses the new provisions that apply to *consumer leases* as well as credit contracts, and the remaining items discuss the application to *consumer leases* of existing provisions applying to credit contracts.

***New provisions applying to both consumer leases and credit contracts***

The Enhancements Act amends the responsible lending obligations in the NCCP Act by introducing a new restriction on the conduct of lessors (and the providers of credit contracts). Lessors are prohibited from unconditionally representing to a consumer that he or she is eligible to enter into a *consumer lease* where the lease is presumed to be unsuitable for the consumer.<sup>109</sup> This is to ensure that representations made as to eligibility take account of the consumer's personal circumstances and that lessors do not encourage consumers to enter into *consumer leases* by informing them that, irrespective of their personal circumstances, the goods will be leased to them.<sup>110</sup>

The Enhancements Act also amends the provisions of the Credit Code that enable consumers to seek a variation of their credit contract or *consumer lease* on the grounds of hardship.<sup>111</sup> In its original form, this provision imposed two threshold requirements: the lessee had to be reasonably unable to perform his or her obligations under the *consumer lease* due to illness, unemployment or other "reasonable cause"; and there had to be a reasonable expectation on the lessee's part that the variation would enable the lessee to perform his or her obligations under the lease. In addition, the lessee could only request to have a *consumer lease* varied in one of three specified ways.<sup>112</sup> The Enhancements Act replaced this provision with one intended to make it "easier" or "simpler" for the lessee to apply for hardship variations.<sup>113</sup> The threshold requirements and the limits placed on the types of variation that could be requested (and made) were removed. A lessee can now apply for a hardship variation by simply notifying the lessor of his or her inability to meet the lease obligations.<sup>114</sup>

It is not obvious, however, that the lessee's position has been improved significantly by this amendment. While it is indeed easier for a lessee to initiate the hardship variation process, the lessor is now able to require the lessee, within 21 days of receiving the lessee's application, to provide information to enable the lessor to decide whether the lessee is able or unable to meet the lease obligations and how, if the lessee is unable to do so, the lease should be varied.<sup>115</sup> Moreover, the threshold requirements have been effectively restored by the note accompanying the new hardship variation provision.<sup>116</sup> This note states explicitly that a lessor does not need to agree to a variation where the lessor does not believe there is a "reasonable cause (such as illness or unemployment)" for

<sup>108</sup> The Revised EM provides a very useful summary of the provisions governing credit contracts which have been applied by the *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth) to *consumer leases*: Revised EM, n 1, pp 95-98 [6.81].

<sup>109</sup> *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth), Sch 1, items 15 and 19.

<sup>110</sup> Revised EM, n 1, p 24 [2.61].

<sup>111</sup> Previously, the Credit Code applied the provision dealing with hardship variations in respect of credit contracts (s 72, before the *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth)) to *consumer leases*: s 177(1)(a) (before the *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth)). The *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth) now creates two parallel regimes for hardship variations: s 72 (credit contracts) and s 177B (*consumer leases*).

<sup>112</sup> Credit Code (before the *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth)), s 72(2). The three types of variation were: (a) an extension of the term of the lease with a concomitant reduction in each rental payment; (b) the postponement of rental payments; and (c) the extension of the term of the lease and the postponement of rental payments.

<sup>113</sup> Revised EM, n 1, pp 14 and 15 [2.6], and 87 [6.36].

<sup>114</sup> Credit Code, s 177B(1).

<sup>115</sup> Credit Code, s 177B(2).

<sup>116</sup> Credit Code, s 177B note.

the lessee's inability to meet his or her lease obligations, or where the lessor reasonably believes that the lessee would be unable to meet his or her lease obligations even if the lease was varied. In addition, while a lessee is no longer restricted to the types of variation that can be requested, a lessor can still require the lessee to provide information about how the lease should be varied.

The process of having a *consumer lease* varied aside, the Enhancements Act does introduce an important new protection for lessees: a lessor must now respond to an application for a hardship variation before enforcing the lease against the lessee.<sup>117</sup> There was no provision, prior to the Enhancements Act, allowing a lessee to forestall enforcement on the grounds of hardship.

### **Increased disclosure obligations**

The Enhancements Act increases substantially the disclosure requirements that apply to *consumer leases* by giving the lessee the same rights as debtors have under the Credit Code in respect of credit contracts to (a) receive periodic statements of account during the term of the lease,<sup>118</sup> (b) request statements of account,<sup>119</sup> (c) require a written explanation of amounts payable under the lease that the lessee disputes<sup>120</sup> and (d) be informed by the lessor the first time there has been a default in relation to a payment being made by a direct debit authorised by the lessee.<sup>121</sup> Much of the information required to be included in these periodic statements of account has not, to date, been finalised but is expected to be the subject of future regulations.<sup>122</sup> Nonetheless, one key matter has already been resolved. The NCCP Regulations now require statements of account in relation to a *consumer lease* to state that the lessee will not own the leased goods at the end of the lease and that the lessee does not have a right or obligation to purchase the leased goods.<sup>123</sup>

The above amendments are concerned only with disclosure during the term of a *consumer lease*. While it is intended that pre-contractual disclosure obligations will be imposed on consumer creditors, there is still no statutory requirement concerning pre-contractual disclosure for *consumer leases* and the content of any such disclosure is also yet to be determined.<sup>124</sup>

The content of pre-contractual and ongoing disclosure for both *consumer leases* and credit contracts is currently being considered by Treasury and is the subject of a discussion paper released for public comment in April 2013.<sup>125</sup> For a consumer to make an informed choice as to whether he or she should lease goods or acquire them in some other way, there must be some basis on which the consumer can compare the cost of a *consumer lease* with alternatives, including those that carry an interest rate. As a first step, Treasury has proposed a "Financial Summary Table" setting out key financial information to be provided to consumers as part of the pre-contractual disclosure.<sup>126</sup> This Table will include the following financial information:<sup>127</sup>

- (i) an estimate of the cash price (that is, an estimate of the price to purchase the goods outright for cash);

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<sup>117</sup> Credit Code, s 179F.

<sup>118</sup> Credit Code, s 175C(1) and s 175D.

<sup>119</sup> Credit Code, s 175E(1).

<sup>120</sup> Credit Code, s 175G(1).

<sup>121</sup> Credit Code, s 179C.

<sup>122</sup> Revised EM, n 1, p 84 [6.21].

<sup>123</sup> *National Consumer Credit Protection Regulations 2010* (Cth), reg 105A.

<sup>124</sup> Revised EM, n 1, p 130 [9.87].

<sup>125</sup> Treasury, *Extension of Disclosure Requirements Applying to Consumer Leases*, n 90; Treasury, *Changes to Disclosure Requirements under the National Consumer Protection Act 2009*, n 91.

<sup>126</sup> Treasury, *Changes to Disclosure Requirements under the National Consumer Protection Act 2009*, n 91, pp 1-2. See also Revised EM, n 1, p 130 [9.87].

<sup>127</sup> We have only included details of the financial information, not all of the information set out in the draft Financial Summary Table. The Credit Code currently makes provision for items (ii), (iii), (iv) and (viii) (but not for the other items) to be provided to the lessee within 14 days of the lease being entered into: Credit Code, ss 174(1) and 175(1). There is, however, currently no provision for pre-contractual disclosure of any of these items.

- (ii) the total amount of the rental payments;
- (iii) the number, amount and timing of rental payments;
- (iv) the other fees and charges levied by the lessor (which requires the lessor to unbundle these fees from the rental payments);
- (v) the total amount payable under the lease (that is, the total amount of the rental payments plus other fees and charges);
- (vi) the amount payable in excess of the cash price;
- (vii) the interest rate (calculated as if the lessee were borrowing the cash price and repaying that through making the same payments as provided for under the lease);<sup>128</sup>
- (viii) the early termination amount; and
- (ix) the late payment fees.

The information contained in this draft Table not only facilitates the comparison of the cost of a *consumer lease* with the cost of *consumer leases* offered by other lessors for the same or similar goods but also, through its expression of that cost as an interest rate, allows a *consumer lease* to be compared with competing credit contracts.<sup>129</sup> As Treasury notes, in this context, “the most simple and easily understood method of comparative pricing is through a comparison based on ... interest rate disclosure”.<sup>130</sup> The chief benefit of these disclosure reforms to consumers, given that many consumers who use *consumer leases* are on low incomes and have limited access to credit, is to enable them to evaluate the relative costs of different *consumer leases* and the cost of a *consumer lease* relative to “fringe” credit products like payday loans. In addition, the rendering of the cost of a lease in the form of an interest rate will facilitate any future extension to *consumer leases* of the interest rate caps that the Enhancements Act has introduced in relation to credit contracts.

Finally, the Enhancements Act requires a lessor to provide the lessee with a statement, at least 90 days before the end of the lease.<sup>131</sup> This statement must include the following information: (a) the leased goods must be returned at the end of the lease and, if they are not, the lessee will be required to make specified monthly payments for each month the goods are not returned; and (b) whether the lessor is prepared to negotiate the sale of the goods to the lessee and, if so, an estimate of the sale price.<sup>132</sup> These provisions – which contemplate the renewal of the lease for an indefinite term (of up to and perhaps even exceeding the economic life of the goods) and also the possibility of the lessee being able to purchase the leased goods at the end of the lease – further weaken the distinction that the bright-line test purports to draw between *consumer leases* and leases that are credit contracts.<sup>133</sup>

### **Prohibited fees**

The Enhancements Act allows specified fees and charges relating to *consumer leases* to be prohibited by regulation.<sup>134</sup> The corresponding provision in the Credit Code dealing with credit contracts prohibits termination fees and charges other than break fees, the administrative costs to the credit

<sup>128</sup> The cash price of the goods is treated as the amount of credit and the amount payable in excess of the cash price is treated as the charge levied by the lessor for providing that credit: Treasury, *Extension of Disclosure Requirements Applying to Consumer Leases*, n 90, p 3; Treasury, *Changes to Disclosure Requirements under the National Consumer Protection Act 2009*, n 91, p 27. This is the same approach taken by the Credit Code to leases that are credit contracts and sales by instalment: Credit Code, ss 9(3) and 11(3) (as regards the content of pre-contractual disclosure for credit contracts, see: Credit Code, s 17; *National Consumer Credit Protection Regulations 2010* (Cth), reg 72; Revised EM, n 1, pp 122-123 [9.49].

<sup>129</sup> Revised EM, n 1, p 131 [9.90].

<sup>130</sup> Treasury, *Extension of Disclosure Requirements Applying to Consumer Leases*, n 90, p 1.

<sup>131</sup> Credit Code, s 175H(1); *National Consumer Credit Protection Regulations 2010* (Cth), reg 105C. There is no corresponding provision applicable to credit contracts (including leases that are credit contracts). No doubt a statement informing the lessee of the status of the goods and his or her rights at the end of the lease is something that a lessee under a hire purchase agreement or a conditional sale would also find useful.

<sup>132</sup> *National Consumer Credit Protection Regulations 2010* (Cth), reg 105C(b) and reg 105C(f) to reg 105C(h).

<sup>133</sup> See also Revised EM, n 1, p 85 [6.25].

<sup>134</sup> Credit Code, s 175A. The *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth) also applies to consumer leases the provision limiting the recovery of enforcement expenses to reasonable expenses: Credit Code, s 179R.

provider of the contract being terminated, and fees or charges incurred by the customer before any credit was provided.<sup>135</sup> It is intended that a similar approach will be adopted in respect of *consumer leases* but the details have, again, been left to future regulations.<sup>136</sup> The outcome here will depend upon the resolution of the question of how best to regulate the early termination of *consumer leases* (see the next section).

### **Early termination of a consumer lease**

The lessee's right, prior to the commencement of the Enhancements Act, to terminate a *consumer lease* before the end of its term, by returning the leased goods to the lessor, has been retained. However, since this right of early termination is confined to situations where the goods have already been delivered to the lessee, a new right of early termination has been introduced by the Enhancements Act allowing the lessee to terminate a *consumer lease* at any time before the delivery of the goods.<sup>137</sup>

The Enhancements Act applies to these two rights of early termination a provision that already applies under the Credit Code to credit contracts, requiring the lessor, on the lessee's request, to inform the lessee of the amount required to be paid on an early termination of the lease.<sup>138</sup> In addition, the lessor is now required to inform the lessee whether the lessor is prepared to negotiate the sale of the leased goods to the lessee and, if it is, to provide an estimate of the sale price.<sup>139</sup> As mentioned above, this last requirement contains the potential to undermine the bright-line test that is central to the separate regulation of *consumer leases* and credit contracts.

Also, as mentioned above, the Credit Code, prior to the Enhancements Act, allowed for the regulations to limit the early termination amount that a lessor could charge by stipulating the principles for the calculation of that amount.<sup>140</sup> To date no provision has been made in the NCCP Regulations for this, leaving the early termination amount to be determined by the contract of lease (in other words, the lessor). Treasury has proposed three options for regulating the amount lessors can charge on the early termination of a *consumer lease*:<sup>141</sup> (a) a formula limiting the early termination amount to an amount based on the present value, at the time of termination, of the rental payments remaining until the end of the lease; (b) limiting the early termination amount to the lessor's reasonable estimate of its loss; and (c) deeming a *consumer lease* to be a sale by instalments based on the quantum of the early termination amount. These three options are all consistent with the characterisation of a *consumer lease* as a finance lease where substantially all of the risks and benefits incidental to the ownership of the leased goods have been passed by the lessor to the lessee.

The advantage of a formula is that it provides greater transparency and also allows for the easier comparison of the leases offered by different lessors as opposed to the situation where it is left to the lessor to determine its losses on a lease-by-lease basis due to the lessee's early termination of a lease. There is, as Treasury notes, the risk that the lessor will seek to recover prospectively any losses that might not be covered by the formula by increasing the rental payments that it charges for *consumer leases*.<sup>142</sup> This, admittedly, is a risk common to all attempts to limit the amount that the lessor can recover on the early termination of the lease. Another advantage of this formula is that, by basing the early termination amount on the present value of the remaining amounts, it avoids giving the lessor a windfall gain (since receiving all or close to remaining amounts at the time of termination would be

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<sup>135</sup> *National Consumer Credit Protection Regulations 2010* (Cth), reg 79A.

<sup>136</sup> Revised EM, n 1, p 84 [6.19].

<sup>137</sup> Credit Code, s 178A.

<sup>138</sup> Credit Code, s 179A.

<sup>139</sup> *National Consumer Credit Protection Regulations 2010* (Cth), reg 105G(c) and reg 105G(d).

<sup>140</sup> Credit Code, s 179(2)(b).

<sup>141</sup> Treasury, *Early Termination Fees under Consumer Leases*, n 90, pp 1 and 4-8.

<sup>142</sup> Treasury, *Early Termination Fees under Consumer Leases*, n 90, p 5.

more valuable to the lessor than receiving them over the term of the lease).<sup>143</sup> In addition, this formula should take account of the economic benefit the lessor receives from the lessee's early return of the goods to avoid the lessor receiving a windfall gain from receiving an early termination payment as well as the opportunity to sell or lease the goods.<sup>144</sup>

The last option considers that where the early termination amount is set at or close to the aggregate rental payments outstanding under a *consumer lease*, the lease should be deemed to be a sale by instalments.<sup>145</sup> Again, to ensure that the lessor does not receive a windfall gain, provision should be made for requiring the lessor to account to the lessee for any economic benefit derived from the early return of the goods.<sup>146</sup>

### **Restrictions on the lessor's enforcement of a consumer lease**

The Enhancements Act retains the previous restriction<sup>147</sup> on the exercise by the lessor of its rights to repossess the leased goods<sup>148</sup> and introduces equivalent restrictions – taken again from the provisions in the Credit Code regulating credit contracts – in relation to the lessor's commencement of enforcement proceedings<sup>149</sup> and the lessor's acceleration of the lease.<sup>150</sup> None of these remedies can therefore be exercised by the lessor without the lessee having been given the opportunity to rectify the default (30 days' notice in the case of repossession and at least 30 days' notice in the case of enforcement proceedings and acceleration).

In addition, a lessee, who has been given notice by the lessor of its intention to commence enforcement proceedings or accelerate the lease, can request the lessor to postpone the exercise of its remedies.<sup>151</sup> This too is taken from the Credit Code provisions applying to credit contracts and is designed to allow the lessee the opportunity to negotiate a postponement of the lessor's enforcement of the lease. While a negotiated postponement, in contrast to a hardship variation, does not explicitly contemplate a variation of the terms of the lease, it may have a similar effect as postponement involves the lessor, at the very least, agreeing to suspend or even waive its rights (and there is also the prospect of the parties agreeing to a rescheduling of the rental payments).<sup>152</sup>

### **Lessee's remedies for misrepresentation**

The application by the Enhancements Act of the concepts of "linked lessor" and "tied *consumer lease*" to *consumer leases* not only addresses the matter of uneven regulation but, just as importantly,

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<sup>143</sup> Burke and Cannel, n 2 at 122.

<sup>144</sup> Credit Code, ss 178A and 179(1). The goods, since they have been returned early, may not have exhausted their economic life and will thus have a residual value to the lessor. See also Burke and Cannel, n 2 at 122-123.

<sup>145</sup> Treasury, *Early Termination Fees under Consumer Leases*, n 90, pp 6-7. It is not clear whether Treasury intends these leases to be treated as credit contracts. The deeming of a lease as a sale by instalments is how hire purchase agreements and conditional sales have been subjected to the provisions of the Credit Code regulating credit contracts.

<sup>146</sup> Treasury, *Early Termination Fees under Consumer Leases*, n 90, p 7; Credit Code, ss 178A and 179(1). See also n 44; Burke and Cannel, n 2 at 122.

<sup>147</sup> Our comments in nn 105-107 on the *Personal Property Securities Act 2009* (Cth) continue to apply to post-*Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth) *consumer leases*.

<sup>148</sup> Credit Code, s 178.

<sup>149</sup> Credit Code, s 179D(1).

<sup>150</sup> Credit Code, s 179G(1). The *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth) introduces a separate definition of "acceleration" applicable to *consumer leases*: Credit Codes 204(1). This is in equivalent terms to the original definition that applied to credit contracts. A lease is accelerated when the lessor becomes entitled (due, for example, to the lessee's default) to the immediate payment of amounts that were not otherwise immediately payable, or when the lessor exercises its discretion to require the payment of amounts that were otherwise payable on a fixed or stated basis under the lease. The *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth) also retains the previous provisions regulating the lessor's right to demand information about the location of the leased goods and the lessor's ability to enter on to residential property to repossess the leased goods: Credit Code, ss 179M and 179N.

<sup>151</sup> Credit Code, s 179H(1).

<sup>152</sup> At a minimum, the notice by the lessor of default and its intention to exercise its rights under the lease will be taken not to have been given: Credit Code, s 179J(1).

recognises the commercial realities of the practice of consumer leasing in Australia. A retailer of goods, when it provides goods on lease to consumers, may, in fact, be operating only as a shop front for the actual lessor. The leased goods may be on display at the retailer's premises, the lessee may be able to take, or organise, delivery of the goods from those premises, and those premises may be where the lessee executes the contract of lease.<sup>153</sup> Despite this, it is not the retailer that is the lessor but a third party with whom the lessee has had no dealings.

The Enhancements Act addresses this by classifying a lease of the above type as a "tied *consumer lease*" and the lessor as a "linked lessor",<sup>154</sup> with the result that the linked lessor is made liable to the lessee for any misrepresentations made by the retailer in relation to the leased goods, the tied *consumer lease* or any other services (such as maintenance) incidental to the lease provided by the lessor.<sup>155</sup> This, again, is an adaptation of existing provisions that apply to credit contracts. By giving the lessee the same rights against the lessor as he or she would have had, had their dealings been with the lessor, the Enhancements Act attempts to provide the lessor with a significant incentive to monitor and even alter the conduct of the retailer.<sup>156</sup>

Finally, the Enhancements Act prohibits any person (including lessors and, in the above example, retailers) from making false or misleading representations in relation to *consumer leases* and also prohibits lessors and retailers from harassing consumers to enter into *consumer leases*.<sup>157</sup> Again, these provisions have been taken from those applying to credit contracts.

### **Parallel regimes for consumer leases and credit contracts**

The Enhancements Act has resulted in two parallel regimes for the regulation of *consumer leases* and credit contracts. The provisions that now apply to *consumer leases* comprise almost all of the provisions concerning credit contracts under the Credit Code that one would expect could be applied to consumer leases.<sup>158</sup> There are only a small number of key omissions, of which one of the most important is the absence of any provision prescribing the contents of pre-contractual disclosure for *consumer leases*. This, however, is unlikely to be left unresolved for long as the issue of disclosure is presently under consideration by Treasury.<sup>159</sup> Another major omission is arguably the absence of any limit on the cost of *consumer leases*, in contrast to the interest rate caps that now apply to credit contracts.<sup>160</sup> A case can be made for the extension of this cap to *consumer leases* on the grounds that *consumer leases* are, like conditional sales and hire purchase agreements, finance leases. Thus, *consumer leases*, in the same way as the Credit Code views hire purchase agreements and conditional sales as financing the lessee's purchase of goods, are financing the lessee's use of the leased goods.<sup>161</sup>

On the basis of our comparison of *consumer leases* with leases that are credit contracts, it is difficult to argue that the former are in some way so different to the latter that they are deserving of separate regulation. The baseline requirement that the amounts payable must exceed the cash price means that the distinction between *consumer leases* and leases that are credit contracts is one of form

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<sup>153</sup> Revised EM, n 1, pp 93-94 [6.69] and [6.73].

<sup>154</sup> Credit Code, s 179S. The retailer is termed the "supplier" under this section.

<sup>155</sup> Credit Code, s 179T(1).

<sup>156</sup> Revised EM, n 1, pp 93 and 94 [6.70] and [6.74].

<sup>157</sup> Credit Code, ss 179U(1) and 179V.

<sup>158</sup> The provisions which have not been applied to consumer leases are chiefly those dealing with interest charges, comparison rates, mortgages, guarantees, related sale contracts and related insurance contracts: see Revised EM, n 1, pp 95-98 [6.81].

<sup>159</sup> Treasury, *Extension of Disclosure Requirements Applying to Consumer Leases*, n 90; Treasury, *Changes to Disclosure Requirements under the National Consumer Protection Act 2009*, n 91.

<sup>160</sup> Credit Code, s 32A(1).

<sup>161</sup> It is possible that *consumer leases* will be subjected to caps on costs equivalent to the interest rate caps recently imposed on credit contracts. The Revised EM recommends the adoption of tiered caps where (i) short-term leases are subject to a cap expressed as a maximum figure for each \$100 of the cash price of the leased goods and (ii) other leases are subject to a cap expressed as an interest rate (presumably, 48% per annum) with the cash price of the goods treated as the amount of credit: Revised EM, n 1, pp 283-284 [11.156] and 297 [11.217].

only. That simple test, in combination with the – until recently – less onerous regulation of *consumer leases* created an environment in which regulatory arbitrage could and did flourish, with harmful consequences for consumers. The Enhancements Act implicitly recognises that consumer leases are not unique through its extensive application of the provisions applicable to credit contracts to *consumer leases*. A simpler and more efficient solution to regulatory arbitrage and the consumer harm flowing from the disparate regulation of *consumer leases* and credit contracts might have been to treat *consumer leases* as credit contracts, rather than now erecting two parallel – and largely equivalent – regimes to govern them separately.

### Consumer leases and the Reform Bill

The reform proposals that have been released following the enactment of the Enhancements Act, like that Act, have been content not to disturb the boundaries established by the Credit Code between *consumer leases* and credit contracts. Nonetheless, one of these key reform proposals – the Reform Bill – contains two measures, which, in conjunction with the changes to the regulation of *consumer leases* effected by the Enhancements Act, should substantially erode, if not extinguish, the opportunities for regulatory arbitrage.

These two measures are:<sup>162</sup>

- (i) repealing the exemptions for very short-term leases (that is, leases with terms of four months or less) and leases for an indefinite term.<sup>163</sup> These leases will now be subject to regulation as *consumer leases*; and
- (ii) introducing a broad anti-avoidance provision, which carries both civil and criminal liability and extends beyond consumer leases to any “scheme” for the purpose of avoiding the application of any provision of the NCCP Act (which contains the Credit Code).

If the Reform Bill is enacted, it will no longer be possible for lessors to avoid the regulation of their leases as either *consumer leases* or credit contracts through the simple device of not including in the contract of lease a right or obligation to purchase and ensuring that the term of the lease is either for four months or less or for an indefinite period.<sup>164</sup> It seems that the rationale for excluding very short-term leases and long-term leases from the Credit Code’s definition of *consumer lease* was to avoid the application of the Code to “pure hire contracts”.<sup>165</sup> It is difficult to support this rationale when the baseline requirement for a *consumer lease* is that the amounts payable under the lease must exceed the cash price for the leased goods. Thus, as the Green Paper acknowledges, true leases for very short terms or for an indefinite term would – even without those exemptions – not be regulated as *consumer leases*.<sup>166</sup>

The Reform Act not only removes the above exemptions but, in their place, introduces two new categories of *consumer lease*:<sup>167</sup>

- (i) “regulated fixed term lease” – this covers *consumer leases* for a fixed term where, at the time of entering into the lease, the lessor knows or has reason to believe that the lessee wants to use the goods for (a) a period longer than the term of the lease and the amounts payable under the lease, had the lease been for that period, are greater than the cash price for the goods, or (b) an indefinite period; and
- (ii) “regulated indefinite term lease” – this covers *consumer leases* for an indefinite term where, at the time of entering into the lease, the lessor knows or has reason to believe that the lessee wants to use the goods for (a) a fixed period and the amounts payable under the lease, had the lease been for that period, are greater than the cash price for the goods, or (b) an indefinite period.

<sup>162</sup> *National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012* (Cth), Sch 5, items 1-3 and Sch 6, item 1.

<sup>163</sup> See further McGill and Wilmott, n 17, pp 899-900.

<sup>164</sup> Credit Code, ss 169 and 171(1).

<sup>165</sup> Green Paper, n 74, p 73. See also Duggan and Lanyon, n 3, p 515.

<sup>166</sup> Green Paper, n 74, p 73.

<sup>167</sup> *National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012* (Cth), Sch 5, item 2.

This seems to be a cumbersome means of removing two exemptions from the Credit Code. With the removal of the two exemptions, the leases that were previously covered by the exemptions would have simply fallen within the original definition of *consumer lease*. The justification for this approach, it seems, is to require lessors to undertake inquiries into the lessee's intended period of use of the goods and to "test the amount payable [under the lease] against this term rather than that provided for in the contract".<sup>168</sup> This may be relevant to the content of the disclosure that the lessor must make to the lessee but that will not be known until further information about the new disclosure requirements for *consumer leases* is released. In any event, a lessor cannot, by forming a particular belief, remove its lease from regulation as a *consumer lease*, as the Reform Bill has only included two new categories within the original definition of *consumer lease* and not otherwise altered that definition.

Given the objective of constraining regulatory arbitrage that underlies the Enhancements Act, the inclusion of a broadly drafted anti-avoidance provision in the Reform Bill is unsurprising. Care, however, needs to be taken when enacting (and enforcing) such a provision to ensure that, in constraining regulatory arbitrage, the provision does not also hinder the development of new consumer credit products that benefit consumers and retard competition within the consumer credit industry.<sup>169</sup>

### CONSUMER LEASES IN PRACTICE

The consumer leasing industry in Australia can be divided into three groups, although, as will be seen below, the distinction between the last two groups is blurred.<sup>170</sup>

In the first group are the mainstream retailers where the *consumer lease* is often entered into not with the retailer but with a third-party linked lessor. This group includes the major national and multi-store retailers.<sup>171</sup> Our survey of this group indicates that two lessors dominate the market for tied *consumer leases*.<sup>172</sup> For these types of leases, the retailer operates, as we have noted above, as a shop front for the linked lessor.<sup>173</sup> The goods that the consumer wishes to lease are typically in stock at the retailer's premises and an employee of the retailer will arrange the *consumer lease* in-store with the consumer (attending to lease documentation, examining the consumer's identification and credit documentation, organising an on-the-spot credit check by the lessor of the consumer, and arranging for the consumer to take possession of the goods), although the contract of lease will be between the consumer and the linked lessor. It is also common for these retailers to offer consumers not just consumer leases but other options, including store credit cards and lay-by sales, for the acquisition of the goods.<sup>174</sup>

The second group comprises retailers who are typically also the lessors under *consumer leases*. The retailers here operate much smaller retail outlets than those in the above group, often with only a single store.<sup>175</sup> These retailers account for the vast majority of the licensed lessors in the Australian market for *consumer leases*.<sup>176</sup> They mainly offer exempt leases<sup>177</sup> and a lease, whether the leases offered by the retailer are *consumer leases* or exempt leases, is usually the only alternative to a

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<sup>168</sup> *National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012* (Cth), Questions accompanying Sch 5, item 2.

<sup>169</sup> Regulatory arbitrage is not necessarily harmful and its benefits depend on whether or not the particular regulation that is being avoided itself is beneficial: Fleischer, n 4 at 234.

<sup>170</sup> Revised EM, n 1, pp 117 [9.27], 260 [11.72] and 261 [11.75].

<sup>171</sup> Revised EM, n 1, pp 117 [9.27], 260 [11.72] and 261 [11.75].

<sup>172</sup> We have not disclosed their identity as we comment below on the costs of the *consumer leases* offered by these two lessors.

<sup>173</sup> Given the stake that a mainstream retailer will often have in upholding its good reputation, it is possible that the monitoring benefits from the *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth) making a linked lessor liable for the misrepresentations of a retailer, in respect of a tied *consumer lease*, could prove to be marginal.

<sup>174</sup> Revised EM, n 1, pp 117 [9.29] and 261 [11.75].

<sup>175</sup> Revised EM, n 1, p 117 [9.27] and 260 [11.72].

<sup>176</sup> Revised EM, n 1, p 117 [9.30].

<sup>177</sup> Revised EM, n 1, p 260 [11.73].

purchase of the goods that the consumer is presented with.<sup>178</sup> In addition, the lessees tend to be on lower incomes (compared to the lessees who deal with the lessors in the first group) and the goods leased through the retailers in this second group tend to be basic household goods.<sup>179</sup>

The last group comprises lessors that do not have a retail presence. These lessors offer their leases on a door-to-door basis, often to remote and primarily Indigenous communities.<sup>180</sup> The goods offered tend to be of lower value than those offered by lessors in the other two groups (typically, the leased goods will have cash prices less than \$1,000).<sup>181</sup> Both *consumer leases* and exempt leases have been used by these lessors.<sup>182</sup>

In the remainder of this part, we present the findings of our review of selected case-files involving consumer leases. We next examine the devices that lessors have resorted to, in seeking to avoid the regulation of their leases as credit contracts or regulation entirely. Finally, we comment on the cost of *consumer leases*.

### **Consumer harm and the uneven regulation of consumer leases and credit contracts**

As part of our research into the regulation of consumer leases in Australia, we analysed a selection of case-files that had been made available to us at the Melbourne office of the Consumer Action Law Centre during July 2012. Our findings from the 11 case-files that were examined are as follows:

- The vast majority of the lessees were dependent on welfare payments or government assistance to service their commitments under their leases (nine out of 11 case-files).
- The leased goods were typically either consumer electronics (in particular, televisions and laptop computers) or motor vehicles.
- The case-files comprised the full range of leases. Six case-files concerned *consumer leases* while two case-files concerned hire-purchase agreements or conditional sales. A single case-file concerned a lease for an indefinite period. The nature of the lease was not absolutely clear in the case of the remaining two case-files.
- The majority of the case-files (seven out of 11 case-files) concerned allegations by the lessees that there had been incomplete disclosure, that the lease had not been properly explained to them or that they had been misled as to the terms of the lease. The result was that the lessees did not understand what amounts they were liable for under the lease and whether they would own the goods at the end of the lease.

These case-files highlight the shortcomings with the regulation of *consumer leases* prior to the commencement of the Enhancements Act. The sample supports the view expressed earlier in this article that the uneven regulation of *consumer leases* and credit contracts created an environment in which the “tension” between the lessor’s preference for *consumer leases* and the lessee’s desire to own the goods he or she had paid for could lead to consumer harm.<sup>183</sup> The regulatory arbitrage engaged in by lessors could thus result in situations where a lessor (or the retailer through whom the lessor was offering leases) might, in order not to deter consumers from entering into leases, not fully inform consumers of, or even actively mislead consumers as to, the terms of the leases.

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<sup>178</sup> Revised EM, n 1, pp 117 [9.30] and 260 [11.72].

<sup>179</sup> Revised EM, n 1, pp 117 [9.30] and 261 [11.76].

<sup>180</sup> Revised EM, n 1, pp 117 [9.30] and 260 [11.72]. The disclosure reforms discussed earlier in this article are likely to be of greatest benefit to those consumers who have a range of lessors and providers of credit contracts to choose from. In contrast, for consumers in geographically remote areas, the door-to-door lessor may be not only the sole alternative to purchasing goods by paying the purchase price in full upfront but also the only means of obtaining access to certain goods. These consumers, in particular indigenous consumers in remote areas, may face a stark choice between no access to goods and access to goods on financially disadvantageous, if not detrimental, terms.

<sup>181</sup> Revised EM, n 1, p 261 [11.76].

<sup>182</sup> Revised EM, n 1, pp 117 [9.30], 126 [9.65] and 263 [11.86].

<sup>183</sup> Revised EM, n 1, pp 108-109 [9.8]. The small sample size and the fact that the sample is skewed towards low income consumers in financial difficulties mean that it is difficult to draw conclusions from the sample beyond those expressed in this article.

This was a particular risk for consumers on low incomes (or who were dependent on social welfare) and who had low levels of financial literacy. This harm to consumers was facilitated by the minimal disclosure obligations that, prior to the Enhancements Act, applied to *consumer leases* where, for example, there was no requirement for the lessor to inform the lessee as to whether the lessee would become the owner of the leased goods. A lessee might therefore not know that, under the terms of the lease, he or she would not become the owner of the leased goods simply by fulfilling their payment obligations under the lease. The consumer might also be unaware of the extent of the fees that the lessor was permitted to charge in addition to the rental payments and of the amount that had to be paid on the early termination of a lease.

### **How is regulatory arbitrage accomplished?**

Our evidence for the prevalence of regulatory arbitrage comes chiefly from Treasury's 2010 Green Paper on "National Credit Reform", the Revised Explanatory Memorandum that was tabled in Parliament with the *Consumer Credit Legislation Amendment (Enhancements) Bill 2012*, a report into consumer leases undertaken by the Micah Law Centre in 2007, and the submissions made by consumer groups during 2012 and 2013 in relation to this Bill and associated reform proposals. Regulatory arbitrage takes two forms:<sup>184</sup>

- (i) A lease is structured to ensure that it falls, through the application of the bright-line test, into the category of *consumer leases* and not into the category of leases that are credit contracts, even though in substance it would be classified as falling into the latter category.
- (ii) A lease is structured to take advantage of the exemptions for very short-term leases and leases for an indefinite term.

### **Redesigning the right to purchase**

The bright-line test, as we have seen, classifies consumer leases according to whether or not the lease contains a right or obligation to purchase. One method that has been employed to avoid classification as a credit contract is for this right or obligation not be documented in the contract of lease, despite it being the common understanding of the parties that the lessee will have the opportunity to purchase the goods at the end of the lease.<sup>185</sup> The disadvantage of this approach for lessors is that, even if the purchase price is set at a nominal amount, the consumer may be deterred from dealing with the lessor because the lease contract will not reflect the consumer's interest in purchasing the goods.

It seems, therefore, that the more common method of avoiding classification as a credit contract is for the right to purchase the leased goods to be recast either as a right to purchase some other goods or not as a right at all. For there to be a right to purchase, the lessee must not be bound to purchase the leased goods but have a true option to purchase, which involves some further positive step being taken by the lessee and which, when that step has been taken, binds the lessor to sell the goods to the lessee.<sup>186</sup> There are several examples of how lessors have recast this right to purchase, to meet the expectation of the consumer that he or she will be able to purchase the goods while ensuring that the lease is not regulated as a credit contract:

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<sup>184</sup> Green Paper, n 74, pp 72-74; Revised EM, n 1, pp 108-109 [9.8], 118 [9.33], 119-120 [9.38] and 259-260 [11.70]. Another form of regulatory arbitrage is the "sale and lease-back": Revised EM, n 1, pp 124-125 [9.58]. We do not discuss this type of dealing in this article as we have assumed that consumers do not already own the goods they are seeking to lease and are thus entering into leases for the purpose of obtaining the immediate use of the leased goods. A sale and lease-back involves a lessee selling goods he or she already owns to the lessor and leasing the same goods from the lessor (thus, with no interruption to the lessee's possession of the goods). The lessee is able to raise funds from the sale of the goods and the lessor obtains its return for providing these funds from the lessee's rental payments. These dealings have routinely been characterised by the courts as constituting secured loans, with the lessee having granted a security interest over the goods to the lessor. See further Beale et al, n 22, pp 266-268.

<sup>185</sup> McGill and Wilmott, n 17, p 888; Green Paper, n 74, p 73; Consumer Credit Legal Centre (NSW), *Submission in Relation to the Outstanding Issues for Resolution on Consumer Leases* (March 2013) p 2.

<sup>186</sup> Beale et al, n 22, pp 250 and 255-256. See also n 51.

- A right to purchase similar or comparable goods to the leased goods, but not the leased goods.<sup>187</sup> The purchase price may vary significantly from lease to lease, ranging from a nominal amount to a further rental payment to the “market value” of the goods;
- A right to make an offer to the lessor to purchase the leased goods which the lessor is free to accept or reject.<sup>188</sup> Unlike the right to purchase under a hire purchase agreement, the lessee’s making of an offer to purchase to the lessor does not bind the lessor to sell the leased goods to the lessee. Again, the purchase price here may vary significantly.
- A right to request the lessor to gift the goods to the lessee’s spouse;<sup>189</sup> and
- A right to retain possession of the goods for an indefinite term, by making a further rental payment or paying a nominal amount.<sup>190</sup>

It is unsurprising that the above practices, especially when coupled with the then minimal disclosure obligations imposed on *consumer leases*, caused consumers to misunderstand, or even to be misled about, the nature of their rights to the leased goods. Moreover, that the above contrivances appear to have led successfully to the leases in question being classified as *consumer leases*, not credit contracts, is further evidence of the artificiality of classifying leases solely on the basis of the absence or presence of a particular contractual term. In contrast, a test that examined the economic substance of the lease would likely lead to many of these contrived *consumer leases* being treated as credit contracts.

The impetus for structuring leases in these ways has been eroded significantly by the Enhancements Act. Having said that, that very Act itself, by creating a situation where the regulatory regime for *consumer leases* now mirrors substantially the regime for credit contracts, raises the question of whether this continued separation of *consumer leases* from credit contracts is necessary.

### **Adjusting the term of the lease**

A lessor can, simply by adjusting the term of its lease, ensure that what would otherwise be a *consumer lease* falls outside the definition of *consumer lease*. If, as noted above, this lessor only provides such leases to consumers, it and its leases will fall completely outside the NCCP Act, Credit Code and NCCP Regulations.<sup>191</sup>

This can be achieved by (a) not setting a fixed term for the lease (so the lease is for an indefinite term)<sup>192</sup> or (b) fixing the term of the lease at four months or less.<sup>193</sup> A period of four months may be insufficient for the lessor to derive its desired return and, in that case, the lease will often make provision for a roll-over on expiry (through an automatic renewal of the lease or renewal on payment of a nominal amount, for another term or successive terms of four months or less).<sup>194</sup>

It is, as we have noted above, difficult to justify these exemptions from the definition of *consumer lease* and, if the Reform Bill is enacted, the exemptions will be repealed. The effect of removing the exemptions will be to require lessors who provide only these types of leases to obtain an Australian credit licence and to comply with the responsible lending obligations under the NCCP Act and the

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<sup>187</sup> Micah Law Centre, n 81, pp 5 and 25-26; Green Paper, n 74, p 73; CALC, *Discussion Paper: Early Termination Fees under Consumer Leases* (7 September 2012) p 2; CALC, *National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012* (1 March 2013) pp 5-6; Consumer Credit Legal Centre (NSW), n 185, p 2.

<sup>188</sup> Micah Law Centre, n 81, pp 21 and 25.

<sup>189</sup> CALC, *National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012* (1 March 2013) p 6.

<sup>190</sup> Micah Law Centre, n 81, p 5; CALC, n 187, p 6.

<sup>191</sup> Revised EM, n 1, pp 122 [9.46] and [9.48], and 127 [9.71] and [9.75].

<sup>192</sup> Credit Code, s 171.

<sup>193</sup> Credit Code, s 171.

<sup>194</sup> Revised EM, n 1, pp 116 [9.25] and 260-261 [11.74].

disclosure obligations under the Credit Code.<sup>195</sup> This compliance burden will, it is expressly acknowledged in the Revised Explanatory Memorandum, likely cause many of these lessors to leave the consumer leasing industry.<sup>196</sup>

### **Recharacterisation of leases by ASIC**

The devices discussed above may not always operate according to their terms. Despite the terms in which the bright-line test and the exemptions to the definition of *consumer lease* have been framed, it is always open to a court or regulator to insist that a lease should be regulated in accordance with its substance, not its form.<sup>197</sup>

ASIC has recently done just that in relation to a putative lease for an indefinite term.<sup>198</sup> The contract of lease in question stated explicitly that the lease was for “an indefinite period”. This was clearly intended to place the lessor outside Australia’s consumer credit laws as the lessor was unlicensed. The lease, however, provided for a minimum term and for the consumer, if he or she terminated the lease before that term had expired, to pay the rental payments that would have fallen due during the remainder of that term. ASIC took the view that these terms meant that, in substance, the lease was for a fixed term (namely, the minimum period), not an indefinite term. The lease, despite the term of the lease being stated to be an indefinite period, was recharacterised as a *consumer lease*, and the lessor was treated as having breached the NCCP Act for entering into *consumer leases* while not holding an Australian credit licence.

### **The cost to consumers of consumer leases**

Contracts for lease can, at a relatively low cost to the lessor due to the simple terms in which the bright-line test and the above exemptions from the definition of *consumer lease* are expressed, be drafted to ensure that the lessor is able to achieve the desired regulatory result. Moreover, a lighter regulatory burden is also a less expensive one to comply with, delivering a competitive advantage to *consumer leases* over credit contracts and exempt leases over both those categories.<sup>199</sup> This advantage that *consumer leases* have over credit contracts has been substantially eroded – if not extinguished – by the Enhancements Act while the exempt leases discussed above will be regulated as *consumer leases* should the Reform Bill be enacted.<sup>200</sup>

Regulatory arbitrage thus meant that lessors could, in effect, contract out of the higher costs associated with more heavily regulated leases. This can boost the returns that lessors expect to receive on their leases by lowering the cost to the lessor of entering into leases (especially where the lessor provides only exempt leases). In addition, the substantially lower disclosure requirements applicable to *consumer leases* and the absence of those requirements in the case of exempt leases significantly impeded the ability of consumers to ascertain the cost of those types of leases and, consequently, to compare leases with alternatives. This very likely led to consumers paying more under their leases than they might otherwise have been prepared to do.<sup>201</sup>

It is also common for the cost of leases (and the returns on them) to be boosted through the lessor “bundling” the leased goods with other services and for the cost of those services to be included in the rental payments. While the Credit Code, prior to the Enhancements Act, required any charges not included in the rental payments to be disclosed to a lessee, it did not require the lessor to disclose to the lessee whether the rental payments included charges for services in addition to the provision of the

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<sup>195</sup> Revised EM, n 1, p 131 [9.89].

<sup>196</sup> Revised EM, n 1, p 132 [9.95].

<sup>197</sup> See further McCormick R, *Legal Risk in the Financial Markets* (Oxford University Press, Oxford, 2006) pp 212-215; Benjamin J, *Financial Law* (Oxford University Press, Oxford, 2007) pp 134-135.

<sup>198</sup> ASIC, *ASIC Accepts Enforceable Undertaking from Mr Rental* (13-022MR, 12 February 2013). The material facts are summarised in the Enforceable Undertaking dated 8 January 2013 between ASIC and Mr Rental Australia Pty Ltd.

<sup>199</sup> Revised EM, n 1, p 110 [9.11].

<sup>200</sup> Revised EM, n 1, pp 133-134 [9.101].

<sup>201</sup> Revised EM, n 1, pp 124 [9.57], 125 [9.60] and 9.90 [9.90].

goods and what the separate amounts for those charges were.<sup>202</sup> Accordingly, rental payments often included charges for maintenance and repair warranties, insurance for theft or damage, and insurance for unemployment or disability, and the lessee was unable to ascertain the cost of these services as distinct from the cost of leasing the goods.<sup>203</sup> This, too, impeded the ability of lessees to assess the cost of leasing goods and to compare that cost with the cost of alternatives.

In these circumstances, it is unsurprising that *consumer leases* are relatively expensive for consumers and have generated significant returns for lessors.<sup>204</sup> That finding, contained in the Revised Explanatory Memorandum, is consistent with the findings of our survey conducted between June and September 2012 of the “price premiums” charged on *consumer leases* by a major unlinked lessor (UL1) and two major linked lessors (LL1 and LL2). This price premium is the percentage by which the total amounts payable under a lease exceed the cash price of the leased goods. This can be expressed as:

$$\left( \frac{\text{Total Amount} - \text{Cash Price}}{\text{Cash Price}} \right) \times 100\%.$$

UL1 falls into the first group of retailers offering *consumer leases* described above and LL1 and LL2 provide *consumer leases* through several of the other retailers that also fall into that first group. UL1 offers *consumer leases* exclusively. We used UL1’s in-store catalogue from July 2012 as a guide to the amounts charged under UL1’s *consumer leases*. There was, at the time of our study, no obligation for lessors to disclose the cash price of the leased goods or the excess over that price that was being charged under the lease. Accordingly, in order to establish a base-line for the cost of the goods that UL1 was offering for lease, we used the current retail prices offered by online retailers during July 2012 for the same goods as a proxy for the cash price of the goods. We calculated that UL1 was charging price premiums under its *consumer leases* ranging from 58% to 408% with an average price premium of 164%. The average effective annual percentage rate (APR) was 37%. The APR, we used, is the annual compound interest rate applied to the cash price of the leased goods over the term of the lease to obtain the total amount payable under the lease. The effective APR is the amount of annual compound interest which has to be “undone” on the total amount payable to re-obtain the cash price of the item. This can be expressed as:

$$\left\{ \left[ \left( \frac{\text{Total Amount}}{\text{Cash Price}} \right)^{\frac{1}{\text{Lease Period in Years}}} \right] - 1 \right\} \times 100\%.$$

In the case of both LL1 and LL2, we used the online quote calculators that each of them provided on their own web-sites. These quote calculators allow users to enter cash prices and choose from a range of lease terms. It is possible to use these calculators, since they generate details of the rental payments, to calculate the total amount payable under a lease as well as the price premiums and the effective APR. We set some search parameters<sup>207</sup> and found that:

- LL1 charged price premiums ranging from 98% to 137% with an average price premium of 116%. This generated an effective APR of 26% to 33% with an average effective APR of more than 29%.

<sup>202</sup> Credit Code, s 174(1)(d).

<sup>203</sup> Revised EM, n 1, pp 118 [9.31]-[9.32], 125 [9.50] and 123 [9.53].

<sup>204</sup> Revised EM, n 1, p 124 [9.55]-[9.57]. Lessors have also been able to mitigate significantly the credit risk associated with contracting with financially disadvantaged lessees by having rental payments deducted directly from the welfare benefits payable to such lessees: see further Buduls A, *Report of the Independent Review of Centrepay* (Australian Government, Department of Human Services, June 2013) pp 23 and 40.

<sup>207</sup> We selected the following search parameters: (i) a term of 36 months was selected so that the leases provided by LL1 and LL2 could be compared; and (ii) we set the cash price for the leased goods from \$500 to \$5,000 at \$100 increments as most household and other consumer goods would fall within this price range.

- LL2 charged price premiums ranging from 61% to 87% with an average price premium of 79%. This generated an effective APR of 17% to 23% with an average effective APR of more than 21%.

We did not treat each regular lease payment as an amortisation of a lease “loan” (given their regulation as *consumer leases*). This would result in a lower APR than would otherwise have been the case. The lease payments can be amortised using the following annuity formula:

$$\text{Cash Price} = \text{Monthly Payment} \times \left[ \frac{1}{r} - \frac{1}{r(1 - r)^{\text{Lease Period in Months}}} \right]$$

where  $r$  is the APR which accounts for amortisation.

The price premiums charged by UL1 are significantly higher than the price premiums charged by LL1 and LL2. This is arguably attributable to the lower creditworthiness and thus greater risk of default that UL1 is assuming in respect of its lessees compared to the lessees who are the customers of LL1 and LL2’s linked retailers. UL1, like several other unlinked lessors, markets its leases on the basis that it is prepared to offer leases to consumers with impaired credit histories (a practice that is now likely to be curtailed by the amendments to the responsible lending obligations introduced by the Enhancements Act).

The high cost to consumers of *consumer leases* is significant. For low income or financially disadvantaged consumers, in particular, the price premiums that they will have to pay to obtain immediate possession of the leased goods may impact negatively on their financial well-being. The disclosure obligations which have now been applied by the Enhancements Act to *consumer leases*, in combination with the content requirements now being considered by Treasury, should assist consumers in making an informed decision as to whether a *consumer lease* is a suitable product for them.

## CONCLUSION

In this article, we have argued that the distinction drawn by Australia’s consumer credit laws between *consumer leases* and credit contracts is artificial and should be abandoned. That distinction, which is based solely on the presence or absence in the contract of lease of a right or obligation to purchase the leased goods, has created considerable opportunities for lessors to engage in regulatory arbitrage. It has also created a situation in which consumers, particularly vulnerable consumers on low incomes and with low levels of financial literacy, could be – and, indeed, were – misled as to their rights in respect of the leased goods.

The Enhancements Act has substantially levelled the “playing field” between consumer leases and credit contracts, and has thus significantly reduced the opportunities for regulatory arbitrage. Moreover, the Act, by bringing the disclosure requirements applicable to *consumer leases* in line with those that apply to credit contracts, has gone a long way towards addressing the consumer harm flowing from regulatory arbitrage. For example, the provision of two simple but powerful items of information – the excess payable under a *consumer lease* over the cash price of the leased goods, and the statement of the cost of the lease as an interest rate – should greatly assist consumers in “shopping” for affordable *consumer leases*.

There are a number of matters relating to *consumer leases* that still need to be resolved but these are currently on the reform agenda. The Reform Bill will, by repealing the exemptions for very short-term leases and leases for an indefinite term, complete the task of dealing with regulatory arbitrage begun with the Enhancements Act. In addition, Treasury is currently considering introducing limits to what lessors can charge on the early termination of a *consumer lease* and there is the possibility that *consumer leases* will be subjected to caps on rental payments analogous to the interest rate caps that the Enhancements Act introduced for credit contracts. The reform of the regulation of *consumer leases* will largely be complete once these matters have been addressed.

Yet, in spite of these reforms, there remain in Australia separate regimes under the consumer credit laws for the regulation of *consumer leases* and credit contracts. This strikes us as unduly complicated and inefficient. We consider that there is no good reason to regulate *consumer leases*

separately to credit contracts, particularly in light of how the Enhancements Act has extended the regulations governing credit contracts to *consumer leases*.<sup>210</sup> Nonetheless, in terms of dealing with regulatory arbitrage and issues of consumer harm, the current regulatory environment is to be greatly preferred to the way in which *consumer leases* were regulated before the Enhancements Act.

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<sup>210</sup> Further regulatory intervention may, apart from the benefits discussed in this article, also involve costs, in particular compliance costs, for lessors. These costs may be passed on to consumers, including low income consumers. Some lessors may, because of the increased costs of operating their business, even decide to exit the market, reducing the range of leases available to consumers. The costs to lessors, that are already required to comply with the Credit Code (which, should the *National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012* (Cth) be passed, will encompass almost all providers of *consumer leases*), of regulating *consumer leases* as credit contracts are, however, likely to be low: Revised EM, n 1, pp 132-133 [9.93]-[9.98].