PROTECTING THE CONSUMER HOLDING ACTIVE ENTITLEMENTS WHEN A COMPANY CEASES TO TRADE: A LEGAL ANALYSIS

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ABSTRACT

Since the industrial revolution consumers have been caused detriment and left with very little option when a company they are dealing with becomes insolvent. Consumers may have placed a deposit on goods not yet received, purchased gift cards not yet used, or have a product warranty not yet expired. These consumers can apply to become an unsecured creditor of the insolvent company with low prospect of a return. There are, however, a small number of consumer groups such as investors in the Stock Market, Home Builders and Employees of insolvent companies who have been supported by government action. Governments in other jurisdictions such as the USA and the European Union have also enacted this support action. This thesis explores the regulatory developments behind those government actions in Australia, USA and the EU using doctrinal analysis and draws a comparative analysis. Using the Bank Deposit Insurance scheme model, used in most countries of the world, as a basis, the thesis then develops legislative guidelines for a compensation scheme to support all consumers who may have been caused detriment when a company ceases to trade.

CERTIFICATION OF THESIS

This Thesis is entirely the work of Gary Ian Houston except where otherwise acknowledged. The work is original and has not previously been submitted for any other award, except where acknowledged.

Principal Supervisor: Associate Professor Noeleen McNamara

Associate Supervisor: Dr Rhett Martin

Student and supervisors signatures of endorsement are held at the University.

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In memory of Christopher John Mariner (1961-2018).

TABLE OF CONTENTS

Chapter Six – Conclusions & Recommendations

LIST OF FIGURES

LIST OF TABLES

ABBREVIATIONS

AASB	Australian Accounting Standards Board
ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
ACCI	Australian Chamber of Commerce and Industry
ACCS	Australian Consumer Compensation Scheme
ACL	Australian Consumer Law
AMA	Australian Medical Association
ANA	Australian Natives Association
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ASX	Australian Stock Exchange
ATO	Australian Tax Office
ATOL	Air Travel Organiser's Licence
CAANZ	Consumer Affairs Australia and New Zealand
CAF	Consumer Affairs Forum
CCAAC	Commonwealth Consumer Affairs Advisory Council
CEO	Chief Executive Officer
COAG	Council of Australian Governments
CSR	Corporate Social Responsibility
DIS	Deposit Insurance Scheme
DOCA	Deed of Company Arrangement
ECJ	European Court of Justice
ECSC	European Coal and Steel Community
EEC	European Economic Community
EESS	Employee Entitlements Support Scheme
EU	European Union
EUR	Euro
FCS	Financial Claims Scheme
FDIC	Federal Deposit Insurance Corporation
FEG	Fair Entitlements Guarantee
FINRA	Financial Industry Regulatory Authority
FSCS	Financial Services Compensation Scheme
FTC	Federal Trade Commission

GDP	Gross Domestic Product
GEERS	General Employee Entitlements Redundancy Scheme
GFC	Global Financial Crisis
IADI	International Association of Deposit Insurers
ICD	Investor Compensation Scheme Directive
NEST	National Entitlement Security Trust
NGF	National Guarantee Fund
NSW	New South Wales
NYSE	New York Stock Exchange
OECD	Organisation for Economic Co-operation and Development
OMC	Open Method of Coordination
PJC	Parliamentary Joint Committee
PPSR	Personal Property Security Register
PWC	Price Waterhouse Coopers
SA	South Australia
SEGC	Securities Exchanges Guarantee Corporation
SIPC	Securities Investor Protection Corporation
SME	Small and Medium Enterprises
TCF	Travel Compensation Fund
TEU	Treaty of the European Union
TITP	Travel Industry Transition Plan
TPA	Trade Practices Act
UCC	Uniform Commercial Code
UK	United Kingdom
UNCTAD	United Nations Conference on Trade and Development
USA	United States of America
USD	USA Dollars
VIC	Victoria
WA	Western Australia

ONE

INTRODUCTION

1.1 Introduction

Consumers in Australia enter into contractual relationships with suppliers every day.[1] Both the consumer and the supplier rely on the other party to fulfil their obligations of the contract.[2] The consumer will offer money in exchange for products or services from the supplier. If the desired product is immediately available, the consumer will exchange money for the product and take delivery of the product. The consumer relies on the supplier or manufacturer to ensure that the delivered product meets Australian safety standards, that the product will be identical to that advertised or displayed to the consumer, and that the product will be of acceptable quality. The consumer also relies on the manufacturer to ensure there are ample spare parts and also that any express warranty will be supported in case of any problems with the product. The Australian Government has enacted legislation as the Australian Consumer Law,[3] which now 'guarantees' that the consumer can rely on the supplier, or product manufacturer to meet those standards.[4] However, if the supplier or manufacturer ceased to trade, the consumer could no longer rely on any of those guarantees. If the product subsequently requires repair or replacement within the guarantee timeframe, the consumer will be caused detriment, as they will be out of pocket by those costs.

When the desired product is not immediately available for delivery to the consumer, the supplier often requires a deposit from the consumer to continue to order the specific product for the consumer. If the supplier or manufacturer ceases to trade before that product is delivered to the

[1] Caddy J, L Delaney, C Fisher and C Noone (2020), 'Consumer Payment Behaviour in Australia' March RBA *Bulletin* <https://www.rba.gov.au/publications/bulletin/2020/mar/consumer-payment-behaviour-in-australia.html>.
[2] John W Carter, *Carter's Guide to Australian Contract Law* (LexisNexis Butterworths, 1st ed, 2006), 4.
[3] *Competition and Consumer Act 2010* (Cth) Schedule 2.
[4] Ibid ss51-59.

consumer, the consumer could no longer rely on that supplier or manufacturer for delivery. The consumer would be caused detriment and left out of pocket by the cost of the deposit. When a consumer purchases a branded gift card from a supplier, and that supplier ceased to trade, the consumer would be caused detriment as they could no longer use that gift card and be out of pocket by the value remaining on that gift card.

At the time that a supplier or manufacturer ceases to trade consumers can be caused detriment. The only avenue for consumers in that situation, currently in Australia and most countries around the world, is to apply to become an unsecured creditor in the insolvency proceedings of the collapsed entity,[5] with little prospect of recovering any of their lost funds.[6] It must be acknowledged here that unsecured creditors may include smaller business entities as well as consumers. Smaller business entities that were not able to include a security as part of their contract were nevertheless able to negotiate terms and prices that may have taken into account the inherent risk involved without any security in place.[7] Business entities in general also have the capacity to make inquiries as to the financial health of those with whom they wish to deal.[8] Consumers have no such opportunity and thus become reluctant creditors and therefore the focus of this thesis. As will be highlighted in Chapter Four, consumers have already been the focus of other regulatory reforms. For the purposes of this thesis the value of the deposit, the value of gift cards, and the potential claim on a consumer guarantee or express warranty will be collectively described as Active Entitlements.

In the one month of December 2020 alone, the retail sales turnover in Australia was over $33 Billion.[9] Retail turnover includes industry groups such as food retailing, household goods (furniture, electrical and electronic goods),

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[5] Michael Murray and Jason Harris, *Keay's Insolvency: Personal and Corporate Law and Practice* (Lawbook Company, 7th ed, 2011), [6.380].

[6] Consumer Affairs Victoria, *Insolvency* (25 September 2019) Consumer Affairs Victoria < https://www.consumer.vic.gov.au/products-and-services/refunds-repairs-and-returns/insolvency> "Unsecured creditors are last in line, after secured creditors (such as banks), the costs of the administration, and employee entitlements. Often there are little or no funds remaining for unsecured creditors".

[7] Steve Knippenberg, 'The Unsecured Creditor's Bargain: An Essay in Reply, Reprisal, or Support?' (1994) 80(8) *Virginia Law Review* 1967, 1969.

[8] Ibid.

[9] Australian Bureau of Statistics, *8501.0 - Retail Trade, Australia, Dec 2020* (5 February 2021) Australian Bureau of Statistics <https://www.abs.gov.au/statistics/industry/retail-and-wholesale-trade/retail-trade-australia/dec-2020>.

clothing and footwear, recreational goods, and restaurants. This volume of consumer spending illustrates that there are hundreds of thousands of consumer contracts occurring each month in Australia.[10] In the same month of December 2020, 614 companies entered into external administration across Australia whilst in the financial year 2019-2020, 7362 companies entered into external administration.[11]

This thesis considers the consumers who have been caused detriment and contemplates:

Protecting the consumer holding active entitlements when a company ceases to trade: A legal analysis.

Furthermore, the following issues are examined in this thesis:

- What currently happens in Australia regarding consumer protection in the event of company insolvency?
- Are there consumer protection measures under these circumstances in the jurisdictions of the USA and European Union that may inform Australian policy and legislation?
- What possible future regulatory reforms or other mechanisms within Australia could provide better consumer protection?

The definition of *consumer* in this thesis, and the benefits for whom this thesis strives to achieve, are those as defined in the *Competition and Consumer Act 2010* (Cth) Schedule 2 s3. (The relevant subsections of s3 have been included only).

> **3 Meaning of *consumer***
>
> *Acquiring goods as a consumer*
>
> (1) A person is taken to have acquired particular goods as a ***consumer*** if, and only if:
>
> (a) the amount paid or payable for the goods, as worked out under subsections (4) to (9), did not exceed:

[10] John W Carter, above n 3,3.
[11] Australian Bureau of Statistics, above n 7.

(i) $100,000; or

(ii) if a greater amount is prescribed for the purposes of this paragraph—that greater amount; or

(b) the goods were of a kind ordinarily acquired for personal, domestic or household use or consumption; or

(c) the goods consisted of a vehicle or trailer acquired for use principally in the transport of goods on public roads.

(2) However, subsection (1) does not apply if the person acquired the goods, or held himself or herself out as acquiring the goods:

(a) for the purpose of re-supply; or

(b) for the purpose of using them up or transforming them, in trade or commerce:

(i) in the course of a process of production or manufacture; or

(ii) in the course of repairing or treating other goods or fixtures on land.

Presumption that persons are consumers

(10) If it is alleged in any proceeding under this Schedule, or in any other proceeding in respect of a matter arising under this Schedule, that a person was a consumer in relation to particular goods or services, it is presumed, unless the contrary is established, that the person was a consumer in relation to those goods or services.

1.2 Creation of Active Entitlements

The legal framework in Australia with regard to contracts in general is mostly governed by that of common law, with some assistance from State legislation,[12] whilst some actions by corporations over consumers is regulated by Commonwealth legislation.[13]

A consumer will consider an offer[14] from a supplier and, after some discussion about possible terms of sale, will make an acceptance[15] of the offer and agree to the terms and conditions explained and pay the required consideration.[16]

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[12] For example; *Sale of Goods Act 1896* (Qld); *Property Law Act 1974* (Qld).

[13] *Competition and Consumer Act 2010* (Cth).

[14] *Australian Woollen Mills Pty Ltd v The Commonwealth* (1954) 93 CLR 546, 555.

1.2.1 Gift Cards

A relatively new option, as a gift to give friends or loved ones rather than actual product that may or may not be of use to the giftee, has been a gift card or gift voucher.[17] Gift cards can be offered by an original store and gift cards can also be available from a neutral supplier such as Visa.[18] Visa gift cards can be used at multiple locations (store independent) whereas an original store gift card can only be used within that original store's locations.[19] This thesis is focused upon the original store gift card.

Payment of consideration for a gift card transfers the value of that consideration into a card or voucher that acts as a token for that same value.[20] Upon presentation of that gift card or voucher at the representative store, value can be used from that voucher or gift card to purchase goods, as if that card or voucher were real currency. If the original store company becomes unable to recognise the gift card as consideration for a purchase, the consumer is left with an active entitlement. More details about gift cards are at 1.6.

1.2.2 Product Warranty

Where a tangible consumer product[21] has been the subject of the consumer contract,[22] that product will be supplied along with a warranty from the manufacturer[23] or supplier or both, depending upon the arrangement between the manufacturer and supplier. That warranty is an express warranty.[24] Other

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[15] *Integrated Lighting & Ceilings Pty Ltd v Philips Electrical Pty Ltd* (1969) 90 WN (Pt 1) (NSW) 693.
[16] *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd* [1915] AC 847, 855.
[17] Jennifer Offenberg, 'Markets: Gift Cards' (2007) 21 *Journal of Economic Perspectives* 227.
[18] Erhard Valentin and Anthony Allred, 'Giving and getting gift cards' (2012) 29(4) *Journal of Consumer Marketing* 271.
[19] Offenberg, above n13.
[20] Ibid.
[21] *Competition and Consumer Act 2010* (Cth) Sched 2 s2 'consumer goods'.
[22] *Competition and Consumer Act 2010* (Cth) Sched 2 s23(3).
[23] *Competition and Consumer Act 2010* (Cth) Sched 2 s7.
[24] *Competition and Consumer Act 2010* (Cth) Sched 2 s2.

implied warranties, or Consumer Guarantees,[25] are provided by the Commonwealth Government under the Australian Consumer Law. Both forms of warranty are effective immediately the consumer contract has been completed, and goods delivered. If the provider of the products, and therefore the warranty, becomes unable to fulfil its obligations under either warranty, that leaves the consumer with an active entitlement. The actual value of the express warranty and implied warranty is further discussed at 1.4.

1.2.3 Deposit Paid

In the situation where the goods are not available for immediate delivery standard commercial options may be to pay the full consideration on the expectation of promised delivery, or pay a deposit awaiting full delivery.

An implied term of a contract is that each party must be ready, willing and able[26] to perform their part of the bargain. Where, as is the usual case, the purchaser is unable to perform their part of the bargain by having sufficient funds or change of mind, the supplier retains the deposit, claimed as some damages towards their effort to complete the bargain. The formality of this process is that the supplier rescinds the contract due to the inability of the purchaser to be ready, willing and able.[27]

Conversely therefore, if the supplier was not ready, willing or able to perform their part of the bargain, the purchaser should be able to rescind the contract. In the case of the product, the subject of the contract, becoming unavailable at no fault of the supplier, the deposit would be refunded to the purchaser. In some circumstances the supplier may attempt to offer the purchaser an alternative product, but the option to rescind would be at the discretion of the purchaser.

Repudiation can also be found where a party's conduct can amount to an implied refusal to perform.[28] Furthermore if a party were to commit an act, which prevented it from performing the contract, it would amount to

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[25] *Competition and Consumer Act 2010* (Cth) Sched 2 Part 3-2 Div 1.
[26] *Foran v Wight* (1989) 168 CLR 385.
[27] John Carter, 'Adequate Assurance of Due Performance' (1996) 10 *Journal of Contract Law* 1.
[28] *Universal Cargo Carriers Corp v Citati* [1957] 2 QB 401, 437.

repudiation.[29] Therefore, if the supplier company was to become insolvent and unable to perform its part of a contract, surely this is repudiation of the contract at the time of the act of insolvency.

A complication here however, is the time for performance of the contract. It could be said that the supplier has not yet reached the time for performance and indeed the breach of contract may be anticipatory. In *Universal Cargo*[30] it was found that even though a reasonable person may view the situation such that performance cannot be carried out, it would only be viewed as an anticipatory breach. Devlin J suggested that the breach must be proven to be fact. It is submitted that in the case of insolvency of the supplier (and specifically liquidation) performance would be factually very unlikely.[31] The inability must be proven at the time of the promise, or purchaser seeks to terminate the contract.[32] Assuming that can be proven, the actual deposit amount becomes an active entitlement for the consumer.

A consumer that is unable to use a gift card, claim against an express warranty or consumer guarantee, or receive value for their deposit paid when a company ceases to trade, will be caused detriment.

1.3 Consumer Detriment

The underlying concern in this thesis is consumer detriment. This sub-section references four major surveys conducted in the United Kingdom[33], the European Union[34], Australia[35] and in the State of Victoria.[36] It must be noted

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[29] *Synge v Synge* [1894] 1 QB 466.
[30] Carter above n 23.
[31] *Edmonds & Anor v Lombard Finance Pty Ltd (Credit)* [2009] VCAT 2190.
[32] *Sunbird Plaza Pty Ltd v Maloney* (1988) 166 CLR 245.
[33] Oxford Economics, 'Consumer Detriment: Counting the cost of consumer problems' (Oxford Economics, September 2016) <https://www.oxfordeconomics.com/recent-releases/consumer-detriment-counting-the-cost-of-consumer-problems>.
[34] Europe Economics, 'An analysis of the issue of consumer detriment and the most appropriate methodologies to estimate it' (www.europe-economics.com, 2007) <http://ec.europa.eu/consumers/strategy/docs/study_consumer_detriment.pdf>.
[35] Ernst & Young, 'Australian Consumer Survey 2016' (The Treasury, on behalf of Consumer Affairs Australia and New Zealand, 18 May 2016).
[36] Consumer Affairs Victoria, 'Consumer detriment in Victoria: a survey of its nature, costs and implications' (October 2006) <https://www.consumer.vic.gov.au/library/publications/resources-and-education/research/consumer-detriment-in-victoria-a-survey-of-its-nature-costs-and-implications-2006.pdf>

that none of these surveys or reports took into consideration the issue of a company becoming insolvent, bankrupt, or deciding to voluntarily liquidate.

The EU study contains an extensive literature review itself. The authors concluded there was no universal definition of 'consumer detriment', but offered the following:[37]

> We suggest that definitions of consumer detriment fall into two broad categories, which we label "personal detriment" and "structural detriment". These concepts can be defined as follows:
>
> - **Personal detriment** – negative outcomes for individual consumers, relative to some benchmark such as expectations or reasonable expectations;
> - **Structural detriment** – loss of consumer welfare due to market failure or regulatory failure. Economists typically measure consumer welfare using the concept of consumer surplus, which is the difference between what a consumer is willing to pay for a product and what he actually has to pay.

The element of personal detriment may include both financial and non-financial factors, including loss of time and psychological detriment. The report attributes consumer detriment to both market failure and regulatory failure, and potentially to consumer behavior.[38]

> Regulations which could lead, in some circumstances, to consumer detriment include:[39]
>
> - Product bans and restrictions;
> - Intervention in markets to set prices or quantities;
> - Regulatory barriers to entry (e.g. licensing regimes);
> - Restrictions on trade;
> - Regulations which lead to cost increases for firms ("red tape");
> - Restrictions on production activity (e.g. environmental regulations);
> - Acts of omission (i.e. failure to take action to provide a framework for well-functioning markets or to tackle market failure).

Both the UK and Australian surveys included a section that attempted to measure the cost of consumer detriment. The financial numbers, based on the survey respondents having had a product failure in the previous year,

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[37] Europe Economics, above n 29, 3.
[38] Ibid.
[39] Ernst & Young, above n 30, 57.

indicated that in 2015 the cost to UK consumers was 22.9 billion pounds,[40] whilst in Australia in 2016 the cost was 16.31 billion dollars.[41] The estimated cost of consumer detriment for the State of Victoria was 3.15 billion dollars in 2006.[42]

There is no measure of the cost to consumers where a company ceases to trade whilst the consumer has 'active entitlements'. Any proportion of the numbers above in both UK and Australia would be significant and therefore affected consumers would welcome a solution to the issue. Interestingly, the Australian Government produces policy on consumer affairs, and very specifically consumer detriment, guided by a handbook, which is a companion to the OECD Toolkit, which states that:[43]

> Consumer detriment arises when market outcomes fall short of their potential, resulting in welfare losses for consumers. Identifying and measuring the nature and magnitude of consumer detriment (how consumers are being harmed and the number of, and extent to which, consumers are being harmed) is a crucial component of evidence-based policy making.

The measurement of consumers affected by company failure has yet to be implemented.

The companion guidelines also include, within tangible costs, "the cost of repairing and replacing an item"[44] which are clearly relevant if a consumer has active entitlements, which must be called upon, if they are not honored by the relevant company. Furthermore, the guidelines refer to intangible costs, which many consumers may face when confronted with a failed company and the consumer is holding active entitlements. Those costs:[45]

> are largely focused on emotional detriment, and are not normally measured. Emotional detriment attempts to place a value on the frustration, stress, annoyance, disappointment and lack of choice experienced by consumers. Ultimately, it can have very high costs in terms of 'peace of mind' or health effects, if the issue is significant and insidious. In its 2008 *Review of the*

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[40] Oxford Economics, above n 28, 11.
[41] Ernst & Young, above n 30, 65.
[42] Consumer Affairs Victoria, above n 31, 1.
[43] Policy and Research Advisory Committee of the Standing Committee of Officials of Consumer Affairs, 'Consumer policy in Australia: A companion to the OECD Consumer Policy Toolkit' (March 2011).
[44] Ibid .
[45] Ibid 20.

> *Australian Consumer Policy Framework report*, the Productivity Commission added 25 per cent of economic costs to the standard measure of detriment, as a way of estimating the intangible costs of detriment.

As these costs are also not measured there is still a lot of information that should be gathered to fully understand the extent of the cost of consumer detriment when a company ceases to trade.

1.4 Company insolvency

Consumers may deal with two different types of entities; suppliers or manufacturers. Suppliers, commonly known as retailers, purchase goods from suppliers and resell those goods to consumers. Suppliers have some direct responsibilities under the ACL[46] and they also provide consumer guarantee services on behalf of the manufacturer.[47] A manufacturer is an entity that "grows, extracts, produces, processes or assembles goods".[48] A manufacturer can also be an entity that imports goods when the original manufacturer "does not have a place of business in Australia".[49] A manufacturer may also act as a supplier and sell goods direct to consumers. The manufacturer has certain responsibilities under the ACL.[50] Where a supplier becomes insolvent and is therefore unable to perform its specific responsibilities under the ACL, or the manufacturer becomes insolvent and cannot perform its responsibilities under the ACL, the consumer may be caused detriment. Additionally, an entity may under its own power, decide to cease trading and enter into voluntarily liquidation.[51] This decision may also cause detriment to a consumer if there were Active Entitlements at the time the entity ceased to trade. The discussion in this thesis will refer to an entity that has become insolvent, or ceases to trade, and has caused the consumer detriment.

Corporate collapse is not a new phenomenon and consumers have been completing transactions and accumulating Active Entitlements for as long as

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[46] *Competition and Consumer Act 2010* (Cth) Schedule 2 ss51, 52, 53, 57, 59(2).
[47] *Competition and Consumer Act 2010* (Cth) Schedule 2 ss54, 55, 56.
[48] *Competition and Consumer Act 2010* (Cth) Schedule 2 s7(1)(a).
[49] *Competition and Consumer Act 2010* (Cth) Schedule 2 s7(1)(e).
[50] Australian Consumer Law ss54, 56, 58, 59(1).
[51] *Corporations Act 2001* (Cth) s513B.

commerce has been operating.[52] New and continually changing technology has introduced an array of challenges for manufacturers and retailers alike with many falling by the wayside as they fail to meet those challenges. It has been reported[53] that in the solar power industry there were 480 solar manufacturers in operation in 2014, and in 2019 there were only 57. Since 2011, 697 companies that installed solar energy systems at the time have ceased to operate.

ABC News reported[54] that in the two years prior to February 2019 approximately two dozen retail chains had collapsed. "Among the big names that have fallen are Roger David, Marcs, Pumpkin Patch, Metalicus, Laura Ashley, Ed Harry, Top Shop, Toys'R'Us, Doughnut Time, Blockbuster Video, David Lawrence, Herringbone and Rhodes & Beckett".[55] It is not unreasonable to assume that, as a result of transactions with all of the above companies that no longer operate, there would be a significant number of consumers holding any or all of the three Active Entitlements.

The value of unused gift cards would simply be the unused portion of the paid value. The value of a deposit paid is simply that amount. These values are quite tangible and simple to understand, whereas product warranty is less tangible.

1.5 Product Warranty

Since the late 19th century commercial enterprises in Western societies[56] have offered warranties on their products to illustrate the quality of the product and essentially provide an incentive for the consumer to purchase their

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[52] Morton J Horwitz, 'The Historical Foundations of Modern Contract Law' (1974) 87(5) *Harvard Law Review* 917, 919.

[53] Nicole Frost, *How long should a solar power system last?* (20 February 2019) Domain News <https://www.domain.com.au/news/how-long-should-a-solar-power-system-last-801076/?utm_campaign=strap-masthead&utm_source=brisbane-times&utm_medium=link&utm_content=pos5&ref=pos1#>.

[54] Andrew Robertson, *Australian retailers shut down by foreign competition* (21 February 2019) ABC News <https://www.abc.net.au/news/2019-02-21/australian-retailers-shut-down-by-foreign-competition/10832062>.

[55] ASIC, 'Companies entering external administration by industry, July 2013-November 2017' (January 2018) <http://download.asic.gov.au/media/4592525/asic-insolvency-statistics-series-1a-published-january-2018.pdf>.

[56] George L Priest, 'A Theory of the Consumer Product Warranty' (1981) 90(4) *Yale Law Journal* 1297.

product due to its apparent higher quality. Over time, it has been generally noted that the higher the level of warranty provided, the higher the quality of the product.[57] The provision of a warranty by a manufacturer comes at a cost, which is built into the selling price.[58] Ultimately, quality products come at a higher price, not only because of the cost of materials, but also because of their advanced design and production, which in turn allows the supplier to offer a higher level of warranty.

For the average consumer the scale of quality of the product can generally be determined and they can also make a rational decision about the value of the warranty provided during their decision-making process around whether to purchase a product.[59] Consumers do not, however, have tools at their disposal to consider the quality of the selling organisation itself and whether it will be able to meet the provisions of the warranty.

1.5.1 Product Warranty - Concept

In broad terms, the purpose of a product warranty is to establish some level of liability between both the consumer and the manufacturer (or supplier). The warranty provides an assurance to the consumer that the product will perform as specified, for a time that may be stated, as long as the consumer uses the product as intended and, if necessary, performs any required maintenance. Modern product warranties offer minimum provisions as prescribed by statutory requirements, and many warranties will provide provisions over and above the minimum.[60]

As manufacturing became more prevalent in the late 19th century, a standardised product warranty evolved. The product warranty was heavily weighted in favour of the manufacturer and deceit and mistrust became more

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[57] Sanford J Grossman, 'The Informational Role of Warranties and Private Disclosure about Product Quality' (1981) 24 *Journal of Law and Economics* 461.

[58] Anisur Rahman, *Modelling and Analysis of Reliability and Costs for Lifetime Warranty and Service Contract Policies* (Master of Engineering Thesis, Queensland University of Technology, 2007).

[59] S G Corones, *The Australian Consumer Law* (Thomson Reuters, 2nd ed, 2013)36, 38.

[60] D. N. P. Murthy and I Djamaludin, 'New product warranty: A literature review' (2002) 79 *International Journal of Production Economics* 231, 234.

widespread, prompting consumers to see warranties "as indicators of poor quality, with manufacturers offering contracts with no intention of honouring them, and no legal incentive to do so".[61] There are several economic theories surrounding the use and misuse of product warranties. When there is an imbalance in market power held by either a manufacturer or a group of manufacturers within the marketplace, exploitation of the consumer is deemed to be present with regards to the content of the warranty, giving rise to Exploitation Theory.[62] Under this theory, a standardised warranty is unilaterally drafted by either a large manufacturer or a group of manufacturers within an industry segment and involuntarily accepted by consumers. As the consumer needs the goods and there is little or no choice in the marketplace, the consumer must adhere to clauses, which are for the benefit of the manufacturer.[63]

A second theory, postulated by Priest[64], attempts to explain:[65]

> the role of a warranty as a marketer's investment in terms of an insurance policy and repair contract. According to the theory, a marketer's investment in warranty terms will be derived from that demanded by the consumer. To the extent the consumer can repair or replace certain parts of the product less expensively than the marketer, the warranty terms will be more limited. If repairs can be made less expensively by the marketer, the warranty terms will offer greater coverage.

Others have argued that an increase in consumer research would reduce the variation in warranties within a market segment.[66] That theory remains a theory, as it has not been tested to any great length.

The most tested of these theories is the Market Signal Theory. "The Market Signal Theory posits that warranty terms are used by the consumer as a signal of product reliability".[67] The theory explains the relationship between product warranty terms and consumer perception of reliability of the product,

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[61] Ibid, 232.
[62] Craig A Kelley, 'An Investigation of Consumer Product Warranties as Market Signals of Product Reliability' (1988) 16(2) *Journal of the Academy of Marketing Science* 72, 73.
[63] Winand Emons, 'A Survey of the Theory of Warranty Contracts' (1988) *Journal of Economic Surveys* .
[64] Priest, above n 41.
[65] Kelley, above n 47, 73.
[66] Ibid.
[67] Ibid.

and the actual product reliability. Furthermore, the duration of a warranty corresponds directly to the cost to the manufacturer of creating reliability in a product, thereby reducing after sales costs of repair or replacement (discussed in detail in 2.4 below).

In more detailed research Srivastava and Mitra[68] concluded that prior knowledge about the organization providing the warranty can alter the general application of Signal Theory. The authors build on previous studies that confirm the basis of Signal Theory and that cues such as price, warranty and firm reputation are also used as quality signals. The results of their study indicates that 'experts', people who are familiar with the product class, regard the reputation of the firm less and they judge the warranty on its merits as long as they can be assured the firm will meet its warranty obligations. 'Novices', people with no familiarity with the product class, will regard the firm reputation more highly and place a higher value on the warranty if the firm's reputation is higher and vice-versa.[69] This study offers some consideration as to whether current web sites such as Productreview.com.au and similar social media style services that report on firm and product reputation, and indeed the promotion of these by consumer protection groups and Government agencies, do indeed offer greater awareness to potential purchasers.

Clearly the Australian Government has recognised the use of warranties in the marketing process, given the inclusion of the definition of Express Warranty in s2 ACL as "***express warranty***, in relation to goods, means an undertaking, assertion or representation: (c) the natural tendency of which is to induce persons to acquire the goods."

Still, it is important to understand the legal relationship between the consumer and the product warranty.

1.5.2 Product Warranty – The Value in a Warranty

[68] Joydeep Srivastava and Anusree Mitra, 'Warranty as a Signal of Quality: The Moderating Effect of Consumer Knowledge on Quality Evaluations' (1998) 9(4) *Marketing Letters* 327.
[69] Ibid 335.

The value in a warranty can be considered in terms of a number of aspects but the main two are from the manufacturers' perspective and that of the consumer.

> Whenever there is a claim under a warranty, the manufacturer incurs a cost. If the claim is not valid, then the only cost is the administrative cost of handling the complaint. A claim is not valid if it is not covered by the warranty, if the warranty has expired, if the claim is bogus (ie the item has in fact, *not* failed, as claimed), or if the warranty ceases to apply due to consumer misuse of the product. If the claim is valid there are additional costs. These include the costs of labour and parts for repairable items, replacement by a new item for non-repairable items, incidental costs such as shipping…"[70]

Murthy and Blischke also explain that when a dispute arises between consumer and manufacturer there will be additional costs including time and effort to resolve the dispute, along with potential legal costs and court costs.[71] Costs attributed to warranty are unpredictable but typically range from 2% to 15% of sales.[72] Failures of a product during the warranty period are closely related to reliability of the product. Product reliability is the result of the design, development and manufacturing stages of the product. Generally, the less reliability, the greater the negative impact in the warranty period. Some manufacturers have taken a conservative approach and have offered a warranty time far less that the expected lifespan, while others have increased the cost of the product significantly to cover warranty costs.

Murthy and Blischke and many others[73] have approached the analysis of the cost of reliability and the cost of warranty from a mathematical perspective. This thesis does not intend to delve into formulae and equations. Indeed, there are many types of warranties considered in these hypotheses including

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[70] D. N. P. Murthy and Wallace Blischke, 'A Framework for the Study of Warranty' in Wallace Blischke and D. N. P. Murthy (eds), *Product Warranty Handbook* (Marcel Dekker, 1st ed, 1996) , 54.

[71] Ibid.

[72] D. N. P. Murthy, 'Product warranty and reliability' (2006) 143(1) *Annals of Operations Research* 133, 134.

[73] See for instance Chung-Ho Chen, Chao-Yu Chou and Wei-Chen Lee, 'Economic Order Quantity, Process Quality Level, Warranty Period, and Production Run Length Settings' (2014) 40(2) *Arabian Journal for Science and Engineering* 627; Richard Marcellus and Ba Pirojboot, 'Design of Warranty Policies to Balance Consumer and Producer Risks and Benefits' in Wallace Blischke and D. N. P. Murthy (eds), *Product Warranty Handbook* (Marcel Dekker, 1st ed, 1996) ; Arda Yenipazarli, 'A road map to new product success: warranty, advertisement and price' (2014) 226(1) *Annals of Operations Research* 669.

basic free-replacement warranty, related rebate warranty, basic pro-rata warranty, one or two-dimensional free replacement warranties and two-dimensional pro-rata and combination warranties to mention a few.[74] However, it is relevant to understand the factors that contribute to the cost of the product and how the reliability and warranty costs can be managed and balanced based on the manufacturers' requirements. The key elements in this juggling act are Product Reliability, Reliability Improvements, Warranty Terms, Warranty Costs, Sales, Sale Price, Revenue, Profits.[75] Some of the inter-relationships between these elements are explained as follows:

> The link between warranty and reliability is complicated since each affects the other through multiple causal-effect relationships. From the business perspective, there can be multiple goals such as market share, total profits etc. Better warranties impact total sales in a positive manner (due to their promotional effect), but also result in higher warranty costs. The increase in warranty cost implies a higher sale price and this, in turn, has a negative impact on total sales, in turn affecting total profits. Warranty costs can be reduced with improved product reliability. However, this involves additional up-front costs and the outcome of the improvement process is uncertain. Reliability and warranty are two important decision variables that need to be determined optimally to achieve these goals. This requires building models that account for the interaction between the two and their impact on other elements.

Thus, it is clear that the sale price of the item, to the consumer, includes the costs allowed for warranty as well as the usual other manufacturing, marketing and sales costs. More specifically, there will be an add-on cost for the reliability/warranty dichotomy. As Murthy has stated[76], reliability is influenced by decisions in the design, development and manufacturing stages.

> During the design and development stage, product reliability can be improved by either using redundancy or through reliability growth involving test-fix-test cycles. Due to manufacturing variability, not all items produced conform to the

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[74] Wallace Blischke and D. N. P. Murthy (eds), *Product Warranty Handbook* (Marcel Dekker, 1st ed, 1996).
[75] Murthy, above n 57, 138.
[76] Murthy, above n 57, 143-144.

design specification. The reliability of these non-conforming items is inferior to those that are conforming (e.g., they have a higher failure rate, smaller mean time to failure). Through proper quality control schemes one can either weed out non-conforming items through testing or reduce the occurrence of such items through preventive actions.

Reliability improvement and quality control schemes reduce warranty cost but this is achieved at the expense of increased unit manufacturing costs (due to the additional costs during the design and manufacturing stages). These schemes are worthwhile only if the cost incurred is less than the reduction in future warranty costs.

The manufacturer ultimately makes decisions about the product quality/reliability during the manufacturing phases and provides a warranty based on predictions of failure rate. Other issues that affect those decisions include the potential usage of the product. Potential buyers are always unknown for a new product and therefore the usage by certain classes of buyers may be different to that of others, compounding the problem of determining the potential warranty costs due to 'adverse' purchase decisions, that is, a customer buying a product not well suited to their usage intensity.[77] Marketing of products must consider the impact of cost in the marketplace from a competitive perspective. As mentioned earlier, the perception of buyers is usually that the more extensive a warranty, the higher the quality of the product. "Better warranty terms are meant to convey a more reliable and better quality product. When buyers are unable to evaluate reliability and quality there is scope for the manufacturer to exploit this. This leads to the moral hazard problem".[78] Adverse reactions from buyers in the modern day of social media can be very immediate and therefore the moral hazard problem for manufacturers is potentially far less pronounced than in the past.

Other elements to take into account with regards to provision of warranty, regardless of how extensive it may be, is the provision of servicing and the logistics of providing parts or replacements for failed products as well as the management and feedback systems to inform the manufacturing process.

As much as these elements are clearly concerns for the manufacturer, they can ultimately be unknowingly serious concerns for the consumer. If the main

[77] Ibid.
[78] Ibid.

selling product of a company were to fail, the cost to the company for repair or replacement could be catastrophic. An extreme example in recent times occurred in June 2017 when motor vehicle airbag manufacturer Takata Corp of Japan, filed for bankruptcy.[79]

> The filing is the culmination of a saga that began with a recall more than eight years ago but has spiralled as the company's malfunctioning airbag inflators -- which sent shards of metal at drivers and passengers -- have been blamed for at least 17 deaths worldwide.[80]

The filing for bankruptcy has seen various deals completed for other companies to purchase the assets of Takata, but for the consumers who have motor vehicles fitted with these airbags…"This will be a long process under the best of circumstances, and Takata going bankrupt, though not surprising, only adds to a potential increase in the time it takes to replace tens of millions of airbags".[81] Fortunately, consumers are having the airbags replaced due to funding from the automobile makers themselves.

Whilst the use or inclusion of a warranty for a product or service is not a new sales tool in today's marketplace, the length of the warranty for many products is increasing.[82] Other sales incentives amounting to promises into the future are extending well beyond 12 months.[83] The relatively recent changes to consumer protection laws captured in the Australian Consumer Law[84] have expanded upon those in the superseded *Trade Practices Act 1974* (Cth) and provide guarantees to consumers on many fronts, including the quality and durability of a product,[85] that the product is reasonably fit for purpose[86], and

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[79] Jethro Mullen, *Takata, brought down by airbag crisis, files for bankruptcy* (26 June 2017) CNN Money <http://money.cnn.com/2017/06/25/news/companies/takata-bankruptcy/index.html>.
[80] Jie Ma et al, *Roiled by Airbag-Recall Crisis, Takata Files for Bankruptcy* (27 June 2017) Bloomberg <https://www.bloomberg.com/news/articles/2017-06-25/takata-seeks-u-s-bankruptcy-protection-after-air-bag-recalls>.
[81] Ibid.
[82] See for example 5-year car warranty at GM Holden Ltd, *Astra GTC* (2016) <https://www.holden.com.au/offers/astra/my16-astra-gtc-manual>, 10-year inverter warranty and 25-year panel warranty for solar power system at Prime Solar, *Solar Power Systems* (2016) <http://primesolarpower.com.au>.
[83] See for example 5-year free car servicing at Hyundai Motor Company, *Santa Fe 30th Anniversary* (2016) <http://www.hyundai.com.au/offers/santa-fe-30th-anniversary/santa-fe-30th-anniversary>.
[84] *Competition and Consumer Act 2010* (Cth), Schedule 2.
[85] *Competition and Consumer Act 2010* (Cth), Schedule 2, s54(1).
[86] *Competition and Consumer Act 2010* (Cth), Schedule 2, s55(1).

provision of goods as described.[87] These provisions do not have a fixed time limit, which is subject to consideration of a number of factors.[88] These guarantees, and any warranty provisions included by the supplier, only offer the consumer some value however, whilst the supplier remains operational. This is the issue that is at the heart of this thesis.

1.6 Gift Cards

Gift cards, in the form of the plastic credit card size well known today, were first introduced in the USA in 1994 by Blockbuster Entertainment as a way of averting the rampant counterfeiting of their paper gift certificates.[89] Starbucks introduced the first re-usable gift cards in 2001 and "in 2012, 1,500 Starbucks gift cards were purchased every minute in the U.S. and Canada. So far, this year (2013), the coffee giant has sold 450 million cards, worth $16 billion". In Australia, up to $2.5bn is spent on gift cards each year.[90]

There are in fact two types of gift cards that may be purchased:[91]

2. closed loop gift cards that are accepted or honoured at a single retailer or group of affiliated merchants (such as a chain of book stores or clothing retailers) as payment for goods or services; and
3. open loop gift cards that typically rely on a payment system (such as Visa or MasterCard) that can be widely used at a wide variety of retailers that accept or honour cards displaying that network.

Closed loop gift cards are the most popular in the Australian market, but they may be a hazard if the issuer company stops trading.[92] Furthermore, new Federal legislation under the *Treasury Laws Amendment (Gift Cards) Act 2018* (Cth) will ensure that the minimum expiration time for gift cards issued

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[87] *Competition and Consumer Act 2010* (Cth), Schedule 2, s56.
[88] *Competition and Consumer Act 2010* (Cth), Schedule 2, s262(2).
[89] Rose Eveleth, *The Gift Card Was Invented by Blockbuster in 1994* (23 December 2013) Smithsonian.com <https://www.smithsonianmag.com/smart-news/the-gift-card-was-invented-by-blockbuster-in-1994-180948191/>.
[90] Uta Mihm, *How to buy the best gift cards* (19 December 2018) CHOICE <https://www.choice.com.au/shopping/shopping-for-special-occasions/christmas-birthdays-and-gifts/buying-guides/gift-cards>.
[91] Commonwealth Consumer Affairs Advisory Council, 'Gift cards in the Australian market: Final Report' (The Treasury, Australian Government, 6 July 2012) <https://treasury.gov.au/publication/gift-cards-in-the-australian-market-report-2/gift-cards-in-the-australian-market-report/>, 25.
[92] Ibid.

after 1 November 2019 will be at least three years. The extended expiration period may provide a false sense of security, as it will increase the consumers' exposure to a greater possibility of a company collapse if the gift card is not used early.

1.7 Thesis focus and scope

The focus of this thesis is very clear: the concern for consumers who have some financial value owed or potentially owed to them by a company that enters into insolvency. This situation occurs very regularly, not only in Australia, but also in most capitalist societies.[93]

The primary research was conducted for the Australian jurisdiction, as both Consumer Law and Insolvency Law are Commonwealth laws. However, it is quite clear from initial research that the same issue exists in the much larger economies of the USA, and the European Union. The selection of the jurisdictions of the USA and the EU for comparison and examination purposes is due to the similarity in levels of government, yet they have quite different legislative processes, and should therefore provide alternative views.

Overall, it is considered that this topic is currently lacking any academic research and therefore, in lieu of the usual literature review, this study will be underpinned by regulatory theory and social harm theory. The scope of this thesis extends to analysing existing substantive law of Consumer Protection and Insolvency and their history with the view to understanding the reasoning behind those laws. Furthermore, other existing laws that may assist the consumer in a similar situation will also be examined.

Ultimately, the utility and implications of application of any resulting law reform proposals or other protection mechanisms to the local jurisdictions as well as making the proposals politically feasible without potentially alienating the commercial sector, must be considered carefully.[94]

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[93] Graham Hall and Barbara Young, 'Factors Associated with Insolvency amongst Small Firms' (1991) 9 *International Small Business Journal* 1,7.

[94] Department of the Prime Minister and Cabinet, *Australian Government RIS Preliminary Assessment Form: Is a RIS required?* (30 September 2017) Department of the Prime Minister and

1.8 Thesis structure

The background to the elements of the thesis topic has been laid out in this chapter. There can be several financial losses that any number of consumers may incur depending on which companies enter into insolvency. The potential value of those losses has been described along with a focus on detriment as defined by the OECD.[95]

Chapter Two will be a review of the theories that have been developed to both understand and predict regulatory behaviour. As historical legislative changes are examined in Chapter Four, they will be contrasted with regulatory theories to consider whether that style of regulatory instrument may be appropriate as a solution to the thesis topic. Furthermore, a particular focus of this thesis is harm caused to the consumer and social theories will be reviewed to consider why harm caused is a concern within society.

Chapter Three will reveal the extensive effort at the committee level and the legislative level that has been expended to create a network and framework that could capture incidents and events that may cause harm to consumers with the ultimate goal of protecting consumers. Additionally, as the thesis topic considers the event of a company ceasing to trade, the legislation relating to insolvency will also be reviewed to understand how that regulatory framework provides various protections to different classes of creditors and how this is achieved. The developments of these regulatory structures in both the USA and EU will further provide a comparison as to how Australia may differ from those two large free-market economies.

There have been several actions at the regulatory level to shield small classes of consumers from the detriment caused by a company ceasing to trade. Chapter Four reviews those actions in place in Australia in addition to others

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Cabinet <https://www.pmc.gov.au/resource-centre/regulation/australian-government-ris-preliminary-assessment-form-ris-required>.

[95] OECD, 'Consumer Policy Toolkit' (9 July 2010) <http://www.oecd.org/sti/consumer/consumer-policy-toolkit-9789264079663-en.htm>.

in the USA and EU. The chapter will consider each of the protective schemes in place as a possible guide to protecting consumers with Active Entitlements.

Having considered existing schemes and justified the importance of providing protection to this class of creditor, Chapter Five delivers a framework that will guide legislative developers towards a regulatory solution that will compensate consumers with Active Entitlements at the time a company ceases to trade. The framework will be based on a set of core principles defined for the guidance of a compensatory scheme aligned to one of the most common and respected institutions in all countries of the world.

Chapter Six summarises the research within this thesis and defines and confirms a framework for a compensation scheme that can provide a solution in response to the thesis topic, as well as offering some suggestions for future research that could complement this thesis.

1.9 Delimitations

The resulting recommendation from this thesis will be directed towards the Australian economy and will not necessarily be suitable as a solution for the same situation in another jurisdiction. The transfer of the recommended solution to any other jurisdiction should be considered carefully in the light of all existing regulation. The resulting recommendations will not be specific legislation or legislative amendments to the *Corporations Act 2001* (Cth) or the *Corporations and Consumer Act 2010* (Cth) as significant information to enable that function is unavailable.

The warranties considered in this thesis are either those provided by Australian Consumer Law or those implied or expressly provided by a supplier. Other warranties that may be purchased as 'extended warranty' are not part of the considerations of this thesis. Extended warranties are a separate product that can be purchased, usually at the same time as the original product, from a different supplier.[96] Warranties provided by those

[96] Stephen Corones, 'Getting what they paid for: Consumer guarantees and extended warranties' (2011) 39 *ABLR* 331.

products may provide a benefit in parallel to, or past the time limit of, the statutory warranties and supplier provided warranties, that are included in the original purchase price.[97]

1.10 Methodologies

There are several methodologies used in this thesis. Doctrinal Legal Analysis will be used to uncover and describe the existing situation in Australia as well as in the European Union and the USA. Comparative Legal Analysis is also employed as each subtopic is described and then compared for each of the three jurisdictions.

Doctrinal Legal Analysis comprises the steps of identifying the issue at hand, clarifying the relevant law(s), and then applying that law to the issues and reaching a conclusion.[98] The Australian Consumer Law[99] and Insolvency Law[100] will be reviewed in detail to consider the options for a consumer holding active entitlements at the time when the entitlement provider enters into external administration either voluntarily or, more likely, otherwise.

Comparative Legal Analysis comprises a review of 'law', which can be from an overall systems and procedures perspective, or a particular issue within law, and of course, anything in between.[101] One must be attentive to those elements that are similar, and those that are different. Care must further be taken to be aware that even though there may be superficial differences, there may still be functional equivalence.[102]

Functional equivalence refers to, for example, the fact that whilst there may not be an equivalent law in statute, there may be another form or function

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[97] Ibid 332.
[98] Terry Hutchinson & Nigel Duncan, 'Defining and Describing What We Do: Doctrinal Legal Research' (2012) 17 *Deakin Law Review* 83, 106.
[99] *Competition and Consumer Act 2010* (Cth) Schedule 2.
[100] *Corporations Act 2001* (Cth) Chapter 5.
[101] John C Reitz, 'How to Do Comparative Law' (1998) 46 *American Journal of Comparative Law* 617-636, 620.
[102] Ibid.

within that legal system that produces the same outcome.[103] Terminology might be different as well.

This analysis will set the baseline of where the limits of the law are in each jurisdiction and also highlight the gaps between the law and where it needs to be in terms of preserving the rights of consumers holding active entitlements.

1.11 Chapter Summary

Consumers make many transactions every day. Many consumers also accumulate various active entitlements such as the unexpired value of gift cards, the promise of delivery of goods after having paid a deposit, and all goods will have a statutory warranty while others have some further warranty provided by the manufacturer or supplier. Whilst a store remains trading, a consumer may use their gift cards to make purchases. While a manufacturer remains operating, a consumer who needs to make a claim on a warranty may do so. The delivery of goods after a deposit has been paid will happen when the goods are ready for supply and the supplier remains open. If the company ceases to trade, none of those events will happen. The consumer in each of those situations will have to spend more money to regain the same position they were in before the company ceased to trade, thus causing the consumer financial detriment.

The current regulatory process that is available to consumers when a company ceases to trade is to apply to join the group of unsecured creditors. Other members of that group are business entities that have had the opportunity to inquire into the financial health of the company with whom they wish to deal and also negotiate prices that may alleviate some of the risk of the unsecured contract they hold.[104] Consumers conducting simple purchase transactions do not have that ability and therefore need some other type of regulatory protection.

The next chapter reviews theories that explain and consider why regulation occurs, how regulation could be initiated, and the type of regulatory instruments that could be utilised in order to provide greater legal protection

[103] Ibid 621.
[104] Steve Knippenberg, above n 7.

for consumers thus avoiding detriment. Theories from a social harm perspective provide substance as to why the issue raised in this thesis is real and important to society and deserves the investigation afforded by this thesis.

TWO

CONTEMPORARY REGULATORY THEORY & SOCIAL THEORY

2.1 Introduction

As has been highlighted in Chapter One, the topic of this thesis and the effects of company insolvency upon the consumer holding *active entitlements* have not been the subject of significant academic research.[1] In developing original regulation that provides relief for the consumer in such a situation, the methodological and structural guidance of regulatory theory is consulted through a literature review with a more detailed focus on the subject area of consumer protection. When a company ceases to trade the consumer may apply to become an unsecured creditor of the defaulting entity.[2] It was noted in Chapter One that consumers were unable to negotiate contracts whereas trade creditors, also left in the group of unsecured creditors, had that opportunity. As the consumer must essentially 'take it or leave it',[3] and suffer detriment as a result, they deserve greater consideration for protection in the situation of the company ceasing to trade.

To best develop a solution to the topic raised by this thesis, this chapter will analyse the theories developed by scholars and practitioners and, furthermore, consider whether regulatory theory supporting consumer protection is practical or necessary. The literature in this field was largely produced in the 1980s and 1990s with some further work done in the 21st century. Some of this work has come from writers in Europe, and as the European Union developed into a robust marketplace, a number of papers began to draw comparisons with developments in both the USA and the UK. As the thesis topic in this study focuses on detriment caused to consumers,

[1] Journal articles have covered some elements of the issues described, see for instance: Christopher Symes and Beth Nosworthy, 'Prepayment Consumer Creditors: A Special Case for Insolvency Proceedings?' (2017) 25 *Insolvency Law Journal* 29; Alec Samuels, "Prepayments: The Lost Consumer Deposits" [1987] *Journal of Business Law* 30, Mohammed Al Bhadily and Kyle Bowyer ,' The Collapse of Dick Smith and the Problem of Gift Cards: Issues and Alternatives for Consumer Protection' (2018) 26 *Australian Journal of Competition and Consumer Law* 97.
[2] *Corporations Act 2001* (Cth) Part 5.6 Division 6.
[3] Ian Tonking, 'Making Liars of us All!' (2020) 48 *Australian Business Law Review* 89.

this chapter will also review various theories regarding detriment, or financial harm, and consider why it is a concern today and why alternative regulatory solutions should be formulated to mitigate that harm.

2.2 What is regulation?

Regulatory theories have been developed to explain why regulatory measures have been implemented, and to predict the success of future regulatory measures.[4] Factors that affect these explanations include external factors such as the force of interest groups or the underlying nature of the local economy or the global economy, and internal factors such as cultural biases of the regulatory institution.[5] Regulation is a mechanism that affects behaviours and processes, and can be both facilitative and enabling, or preventative. Furthermore, regulation "may be carried out not merely by state institutions but by a host of other bodies, including corporations, self-regulators, professional or trade bodies, and voluntary organizations".[6]

Regulation itself has been practiced for centuries and, for many generations, it was practiced only by a sovereign authority.[7] Today there are many forms of regulation. When one enters a supermarket there are zoning regulations about the location of the supermarket, and others about the opening hours and working conditions. Walking down an aisle one encounters regulated labelling of products. Under the wrapping, a regulator has been concerned with the pesticide levels on fresh fruit and vegetables, while the supermarket owners regulate which products are available and where and how those products can be seen on the shelves.[8]

As social beings, our daily lives are full of regulatory actions.[9] Holding a child's hand whilst crossing the road, assisting with homework, praising a

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[4] Jean-Jaques Laffont and Jean Tirole, 'The Politics of Government Decision-Making: A Theory of Regulatory Capture' (1991) 106(4) *The Quarterly Journal of Economics* 1089, 1090.
[5] Robert Baldwin, Martin Cave and Martin Lodge, *Understanding Regulation: Theory, Strategy, and Practice* (Oxford University Press, Second ed, 2011), 40.
[6] N. Gunningham and P. Grabosky, *Smart Regulation* (Oxford, 1998).
[7] M. Moran, *The British Regulatory State* (Oxford, 2003).
[8] Peter Drahos and Martin Krygier, 'Regulation, institutions and networks' in Peter Drahos (ed), *Regulatory theory: foundations and applications* (ANU Press, 2017) .
[9] Valerie Braithwaite, 'Closing the gap between regulation and the community' in Peter Drahos (ed), *Regulatory theory: Foundations and applications* (ANU Press, 2017) .

colleague's work, and offering advice are all informal regulatory actions. Within this social view, any formal regulation may be intrusive and make "people do things they would not otherwise do and generally interfering in people's lives in intrusive and wasteful ways".[10] However, Valerie Braithwaite believes that regulation need not be dominating, need not involve government, and can "serve a useful and important function for the community".[11]

Overlapping with Braithwaite's views, Fiona Haines[12] posits that regulation is the outcome of risk assessment where risks can be classified as actuarial (the most common), sociocultural or political. Actuarial risk relates to the harm an unwanted external event may cause an individual, a collective or the environment. "A disease, a fall from a height at a worksite and an unintentional release of toxic effluent from a factory would all fall within this conception of risk".[13] Scientific analyses often determine the probability and impact of this type of event, which would fall under the regime of areas such as "infection control, public health, occupational health and safety and environmental protection".[14] Whilst these risks are commonly associated with regulation, paradoxically not all gather the same social and political motivation for regulation, with climate change being a current case in point. The probability of a corporate collapse could be explained in scientific terms and therefore could well be included in the actuarial classification.

Sociocultural risks can be associated with an event that may change the collective health or social order of society and may include new technology that replaces humans and therefore increases unemployment, or digital technology that mediates relationships such as dating applications like Tinder.[15] Political risk can be threats to the legitimacy of the government of the day or the governments' ability to accumulate capital, which is also an economic threat, whilst at the same time being both sociocultural and actuarial. The government promotes its legitimacy by promising to protect the

[10] Ibid 25.
[11] Ibid.
[12] Fiona Haines, 'Regulation and risk' in Peter Drahos (ed), *Regulatory theory: Foundations and applications* (ANU Press, 2017) .
[13] Ibid 183.
[14] Ibid 184.
[15] Ibid 184.

collective against perceived threats, which therefore encroaches on the sociocultural risk. Haines advises that the three risk types do not exist individually but rather in complex interaction.[16]

By the end of the 20th century the business sector and the public in general had seen the inclusion of regulatory measures pervade almost every sector of private life and business, and the appropriateness of regulation was being questioned. The call for the burning of 'red-tape' and 'green-tape' led governments of the day to listen, and reassess.[17] Regulatory instruments and methods continue to evolve with the demands of the day and as new technology challenges current regulatory boundaries so too does, for example, the health and well-being of the collective. "Perhaps supermarkets with their command over the layout of choices to be found in their aisles could be persuaded to bring more healthy choices into focus for busy consumers".[18] General theories of regulation may assist in planning what should be done to address these concerns, which raises the question of why regulation is needed.

2.3 Why regulate?

There are several contrasting views on what animates the regulatory process, with some suggesting there may be an altruistic motive as well as some less altruistic motives.[19] Such motives can also be differentiated according to technical justifications. The basic philosophy of a democratic society is that individuals are elected into government by the people and they will work for the people.[20] One theory of regulation is the 'public interest' theory according to which the government regulates for the benefit of its electors.[21] Defining the 'public interest' can be difficult at times and, as with any government decision,

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16 Ibid 185.

17 See for example Australian Government, *Deregulation Agenda* (9 March 2018) <https://www.jobs.gov.au/deregulation-agenda>,
"The Australian Government is committed to improving the quality of its regulation, including minimising the burden of regulation on businesses, community organisations and individuals".

18 Drahos and Krygier, above n 4, 4.

19 Michael E Levine and Jennifer L Forrence, 'Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis' (1990) 6 *Journal of Law, Economics, & Organization* 167.

20 John Francis, *The Politics of Regulation* (Wiley-Blackwell, 1993).

21 Carol W Lewis, 'In Pursuit of the Public Interest' (2006) 66(5) *Public Administration Review* 694.

not all electors will be satisfied with the result. 'Public interest' reasons for regulating may be based on market failure rationales such as the impact of monopolies, inadequate information available to consumers, maintaining continuity, and availability of services by setting minimum price levels, anti-competitive behaviours or predatory pricing.[22] Thus, evidence of the use of regulation for the public interest should be obvious to those living in industrialised countries where there are high expectations around "safe food, safe consumer goods and safe buildings".[23]

Opposing this view is a theory that posits that regulators are motivated by personal gain. This personal benefit could be in the form of increased personal wealth, either during their tenure as a politician or following that tenure, or it could be in the form of greater chances of winning the next election. 'Capture theory' suggests that regulators can be lobbied by influential groups that want regulation for their benefit.[24] In return for this positive benefit to the lobby group, there will be some personal benefit to the regulator.

Given that government regulators are most usually elected due to their membership of a chosen political party, a third theory focuses on the ideologies of the political party forming government.[25] There can, of course, be a combination of these theories such that a public interest could be isolated based on the ideology of the government, for example social welfare. In relation to this thesis and presentation of the findings for potential legislation, ideological tendencies of political parties would need to be considered very cautiously. A government that is not concerned with the welfare of consumers may not be interested in implementing legislation in support of consumers. Regardless of the motivation for it, how regulation is implemented is another matter.

2.4 Instruments for regulation

[22] Baldwin et al, above n 1, 18.
[23] Haines, above n 8, 181.
[24] Michael E Levine and Jennifer L Forrence, above n 17..
[25] Ibid 175.

The most obvious and most common instrument used to implement regulation in Australia has been substantive law through legislation enacted by the government of the day. Various other options can include local laws, soft law[26] or self-regulation. Furthermore, Baldwin has proposed that "many risks and social or economic problems are controlled by networks of regulators".[27] In Australia, the USA and the EU, legislation is enacted at various government levels; in Australia at Federal and State levels, in the USA at Federal and State levels, and in the EU at the Union level, Country level and Province level. Australian States are divided into council areas and each council can create its own local or by-laws. In relatively recent times there has been discussion regarding 'global governance' where organisations such as the Organisation for Economic Co-operation and Development (OECD), the World Bank, and of course the United Nations, can have a pivotal role in developing guidelines and governance that is then ultimately enforced by national mechanisms.[28] Implicit in the discussion of law and regulatory theory is that neither is static, and as the communities and marketplaces of the world evolve, so too do instruments for regulation.[29] Regulatory theory is generally categorized in accordance with various models, which will be discussed below.

2.4.1 Command-and-Control

"Command-and-control is a form of direct regulation, where the legislature exercises direct responsibility for making laws regulating specific activity".[30] Through the legislative process of any nation, whether it be democratic or totalitarian, rules have been set as commands to the citizens with clear consequences if the rules are broken. The constant evolution of communities and marketplaces, and the expectation of citizens in democratic societies to

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[26] Jykri Tala, 'Soft Law as a Method for Consumer Protection and Consumer Influence. A Review with Special Reference to Nordic Experiences' (1987) 10 *Journal of Consumer Policy* 341.
[27] Baldwin et al, above n 1, 63.
[28] Carol Harlow, 'Law and Public Administration: Convergence and Symbiosis' (2005) 71 *International Review of Administration Sciences* 279.
[29] J Black, 'Critical Reflections on Regulation' (2002) 27 *Aust Journal of Legal Philosophy* 1.
[30] Vijaya Nagarajan, 'From Command-and-Control to Open Method Coordination: Theorising the Practice of Regulatory Agencies' (2008) 8 *Macquarie Law Journal* 5.

be treated with more humanity, has led governments to reconsider the mechanisms with which to regulate.[31]

> …the shortcomings of command-and-control strategies were realised and alternative forms of regulation, including the creation of independent regulatory agencies, became important. The expense of passing and amending legislation, the constraints on engaging in quick and creative responses, as well as the advantages of taking regulation out of politics, were all widely acknowledged, making a regulatory agency an attractive option.[32]

In Australia, the introduction of agencies such as the Australian Competition and Consumer Commission (ACCC), [33] the Australian Securities and Investments Commission (ASIC)[34] and the Australian Prudential Regulation Authority (APRA)[35] occurred through the passing of legislation. These and many other agencies have greater flexibility to react to the demands of the day, rather than the legislature, which directly enforces the legislation over which they were handed control. The ultimate style of regulation used by these agencies is still however, command-and-control.

2.4.2 Responsive Regulation

The main catalyst for a change in attitude, and to move from regulating in a command-and-control fashion to something less constrictive, was the work of Ian Ayers and John Braithwaite. [36] One of the main philosophies of Responsive Regulation was to not only include punitive measures within regulations but also persuasive measures – both the carrot and the stick.

> The core idea of responsive regulation is that regulators should be responsive to the conduct of those they seek to regulate in deciding whether a more or less interventionist response is needed and they should be responsive to how

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[31] Stephen Wilks and Ian Bartle, 'The Unanticipated Consequences of Creating Independent Competition Agencies' (2002) 25(1) *West European Politics* 148.
[32] Nagarajan, above n 24, 7.
[33] *Competition and Consumer Act 2010* (Cth) s6A.
[34] *Australian Securities and Investments Commission Act 2001* (Cth).
[35] *Australian Prudential Regulation Authority Act 1998* (Cth).
[36] Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, 1st ed, 1992).

effectively citizens or corporations are regulating themselves before deciding whether to escalate intervention.[37]

The responsive regulation model relies on a pyramid structure where at the base of the pyramid is the persuasion element, and as one moves up the pyramid the elements become more punitive. The responsive regulation model relies on a significant element of self-regulation at the industry level, allowing the regulatory agency to negotiate at that level before taking punitive actions. The responsive regulation pyramid is a dynamic one that can be developed for each individual requirement.[38] In a later article,[39] Braithwaite has argued that the element of persuasion may or may not include reward, and that reward was not necessarily the best method of changing corporate behaviour – for the good. Providing a reward for good behavior can lead a corporation to create an illusion that they have met the requirements of the reward when in fact they have not. Doreen McBarnet and Christopher Whelan called this behavior 'creative compliance'.[40] The issue with many reward systems is the capacity to measure the level of compliance and Braithwaite contends that punishment is a much less expensive, yet positive, method of regulatory control. Ultimately, "it is best to have a presumption in favour of trying persuasion first, generally reserving punishment for when persuasion fails".[41] An important aspect of applying this style of regulation is the point on the timeline of the life of the project or agency. At the beginning of a program it may be more strategic to employ a greater level of enforcement to maximise immediate engagement and compliance.[42] This approach sets the narrative for the agency and those being regulated and could create a more even playing field where those that attempt to gain competitive advantage from non-compliance would lose that

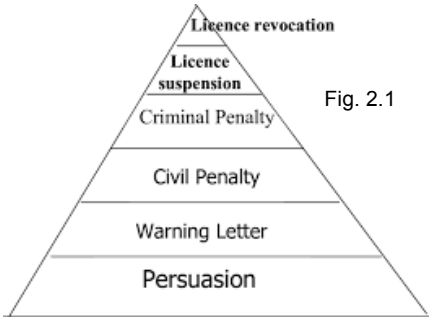

Fig. 2.1

[37] Nagarajan, above n 24, 8.
[38] Ayers and Braithwaite, above n 27.
[39] John Braithwaite, 'Rewards and Regulation' (2002) 29 *Journal of Law & Society* 12.
[40] Doreen McBarnet and Chris Whelan, *Creative Accounting and the Cross-Eyed Javelin Thrower* (John Wiley & Sons, 1st ed, 1999).
[41] Braithwaite, above n 30, 19.
[42] Malcolm K Sparrow, *The Regulatory Craft : Controlling Risks, Solving Problems, and Managing Compliance* (Brookings Institution Press, 2000) 37.

advantage from financial penalties.[43] As the agency or program gains traction, the introduction of a more negotiated compliance would minimise opposition to the regulatory agency over time and reduce compliance burden.[44]
In terms of this thesis, and the concern around companies failing, there is the quandary of how much regulation, and persuasion or punishment, is required to ensure that all companies contribute to the solution. Other forms of regulation may inform this quandary further.

2.4.3 Soft Law

The creation and development of the legal structure of the European Union itself was firstly managed through the introduction of command-and-control style legal mechanisms as indicated above, however, the sensitive nature of social and economic issues called for something more flexible.[45] The Open Method of Coordination (OMC)[46]

> is an EU policy-making process, or regulatory instrument, formally initiated by the Lisbon European Council in 2000. The OMC does not result in EU legislation, but is a method of soft governance which aims to spread best practice and achieve convergence towards EU goals in those policy areas which fall under the partial or full competence of Member States.

Under OMC a number of guidelines have been created, benchmarks set and indicators developed that each Member State can use to review their progress in certain social and economic areas.[47]

2.4.4 Self-regulation

The more recent quest by elected governments to minimize the cost of regulation has led many to review the existence and extent of self-regulatory

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[43] Ibid.
[44] Ibid 38.
[33] Laura Nistor, 'Positive and Soft Law' in *Public Services and the European Union* (Asser Press, 2011) 283.
[46] European Commission, *European cooperation: the Open Method of Coordination*, < http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52014DC0535>.
[47] Nistor, above n 33, 365.

processes within their countries.[48] Australia, along with Canada, Germany, Japan and New Zealand initiated investigations and produced subsequent reports.[49] A paper by Porter and Ronit delves more specifically into the nature and processes of generic self-regulatory schemes, which they indicate have been referred to historically by many names including:

> gentleman agreements, codes of conduct, ethical guidelines, voluntary agreements, standards, certification schemes, guilds, charters, cartels, regimes, syndicates, networks, alliances, self-governments, private governments, private interest governments, partnerships and a vast variety of other forms.[50]

In generic terms, all of these arrangements can be summarized by:[51]

> *self-regulation* as an arrangement, involving formal or informal procedures, rules and norms, that is widely recognized as having the purpose of constraining the conduct of a set of private actors, where the procedures, rules and norms are shaped to a significant degree by some or all of these actors.

There are several main factors that must be maintained by any self-regulatory scheme, including efficiency, transparency and legitimacy. Efficiency must be greater than what government could impose, whilst transparency must be maintained to allow external parties, such as governments and auditors, the capacity to measure efficiency and effectiveness. Legitimacy must exist in order for those who are subject to the self-regulation to be sufficiently willing to be bound by that regulation.[52] This could be a viable option for all industries that deal with the consumer either directly, when taking part-payments for goods and/or services and selling gift cards, or indirectly, when offering a warranty on manufactured goods. Dealing with the issue of insolvency and liquidation, and with supporting the consumer through self-regulation, would take this further than is currently possibly available, and it would go a long way towards a solution to the thesis topic of this study.

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[48] Julia Black, 'Decentring Regulation: Understanding the Role of Regulation and Self-Regulation in a "Post-Regulatory" World' (2001) 54 *Current Legal Problems* 103.
[49] Tony Porter and Karsten Ronit, 'Self-Regulation as Policy Process: The Multiple and Criss-Crossing Stages of Private Rule-Making' (2006) 39(1) *Policy Sciences* 41.
[50] Ibid 42.
[51] Ibid 43.
[52] Ibid.

Porter and Ronit have identified five stages of process that result in the creation of a self-regulatory scheme:[53] agenda-setting, problem identification, decision-making, implementation, and evaluation. Their investigations found that there was no clearly defined pathway and that some stages may occur in alternative order, but the final outcome was still achieved.

Self-regulation was mainly confined to industries and professions, and *agenda-setting*[54] was the early process of actors within those groups coming together to define what the self-regulatory outcome was meant to achieve and how that might be accomplished. This was generally the initiative of existing industry associations that would look to create self-regulation, but the agenda-setting process was generally steered in the direction of prominent or large actors, and the dividing line between this stage of the process and that of problem identification becomes blurred. *Problem identification* involves the reflection or research by member actors to identify issues within any existing standards or frameworks, and any other highlighted areas of concern by both the public and the government related to the industry.[55]

> This process of defining rules, and the often excessive prominence it is given as a portrayal by self-regulatory bodies of what they do, is important for reasons of both practicality and legitimacy: in comparison to states, self-regulatory bodies generally cannot as strongly force regulated actors to comply and consequently they must rely to a greater degree on voluntary compliance, which they often seek to foster by framing regulations as involving high standards that regulated actors would want to follow because it is in their own interest to do so.

The concerns that many have with self-regulation are exposed at this stage of the process. Porter and Ronit suggest firstly that the problems identified would have to be limited and in such proportion that only self-regulation could deal with it, and they should not require any governmental interference; secondly that determination of 'best' practice may incur arbitrary rule making; and

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[53] Ibid.

[54] May-May Meijer and Jan Kleinnijenhuis, 'Issue News and Corporate Reputation: Applying the Theories of Agenda Setting and Issue Ownership in the Field of Business Communication (2006) 56 *Journal of Communication* 543, 545.

[55] Tony Porter and Karsten Ronit, above n 47, 51.

thirdly that problems that could not be managed by the self-regulatory process may not come to the surface.[56]

Decision-making is usually conducted in conjunction with problem-identification, but it is also an on-going process that may be exercised by other committees and working groups. "Decisions often include such future aspects as to how data are to be collected, and if some kind of self-reporting system is to be installed that offers the possibility of self-auditing in evaluating the performance of individual companies".[57] *Implementation* of self-regulation could be the fine-tuning of some existing arrangement or the monumental introduction of a new arrangement within the industry or profession. The self-regulatory scheme must appeal to the regulatees' self-interest and would often include the marketing of industry best practice, thereby drawing customers to the participants. Education about the initiatives and feedback from the scheme is an important element of the implementation phase.[58] As an on-going process the self-regulator should conduct marketing that emphasizes the success of the arrangements supporting the regulated actors. Success stories will be included in the *evaluation* process that would normally be conducted internally, based on criteria set in the agenda-setting stage. Furthermore, when either a major issue arises in the public arena or the government of the day decides to gain an understanding of what is happening in an industry, a review such as that conducted in 2000 would be initiated. The 'Industry Self-Regulation in Consumer Markets' report, prepared by the Taskforce on Industry Self-regulation[59], is analysed in 2.5.4.

In conclusion, Porter and Ronit raise several issues facing self-regulation. They identify a dilemma around whether compliance should rely on market pressures or peer pressure from members of the self-regulated organization, as well as a dilemma about whether the self-regulated body would have the capacity to punish non-conforming members or whether a court should be involved.[60] The authors further suggest that self-regulation and interaction of

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[56] Ibid 52.
[57] Ibid 57.
[58] Ibid.
[59] Taskforce on Industry Self-regulation, 'Industry Self-Regulation in Consumer Markets' (Commonwealth of Australia, Department of Treasury, August 2000).
[60] Tony Porter and Karsten Ronit, above n 47, 58.

members is challenged by geographical constraints as industries expand, and also by new technologies. These issues would need to be kept in mind when developing a solution to this thesis topic.

2.4.5 Network Theories

A more holistic view of regulation in practice is that there are many regulatory bodies involved in regulating an industry. This approach has been known as either *legal pluralism*[61] or as Baldwin et al[62] refer to it, *networked regulation*. This moves regulation from any one entity and makes it 'decentred'.[63] This theory takes into account 'soft law', regulatory bodies at national or state levels, government and non-government, and the variety of self-regulation bodies, and it proffers that any combination and almost any value of input from any or each can result in regulation for a specific requirement.[64] An example of this is the health system in Australia. Whilst the Australian Constitution does not provide a specific power for the Commonwealth to operate public health care, the States legislate for, and run, public hospitals with the assistance of funding from the Federal government through appropriations. The federal government became further involved with the introduction in 1975 of Medicare, which makes payments that supplement doctors' and other fees with the power provided by s51(xxiiiA) Constitution.[65] Along with those levels of legislation the medical profession is under the 'code of conduct' guidance of the Australian Medical Association (self-regulation), and all health practitioners are under the regulatory and licensing supervision of the Australian Health Practitioner Regulation Agency (regulated through Federal legislation since 2010).[66] Other external services include pathology, x-ray as well as services like private health insurance (subject to some

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[61] Miranda Forsyth, 'Legal pluralism: The regulation of traditional medicine in the Cook Islands' in Peter Drahos (ed), *Regulatory Theory: Foundations and Applications* (ANU Press, 2017) .
[62] Baldwin et al, above n 1, 63.
[63] J Black, 'Decentring Regulation: The Role of Regulation and Self-Regulation in a "Post-Regulatory World"' (2001) *Current Legal Problems* 103.
[64] Baldwin et al, above n 1, 160.
[65] Margaret Faux, 'The Constitutional Framework of the Australian health system reform: what's possible and realistic?' (Paper presented at the AHHA: 10 Year Health Agreement Blueprint Roundtable, University of Technology Sydney, 18 September 2017).
[66] https://www.ahpra.gov.au/.

Federal legislation but also self-regulated by setting its own rules regarding payment levels). Doctors can also charge whatever they like.[67]

When there are a number of actors involved in regulating an industry,

> [i]t cannot, for instance, be assumed that all of the involved regulators will have the same substantive objectives or normative conceptions of the 'good'. Their capacities, skills, and resources are also liable to vary, and this is likely to affect not only their preferred approaches to regulation but their responsiveness.[68]

The overall focus of the Australian health legislation is to ensure patients receive the care required at minimal cost, in a safe environment.[69] The AMA is very protective of their member doctors in preference to patients should the need arise,[70] while health insurers would be ensuring they pay as little as possible for services with little regard for patient outcomes.

Research in recent decades has included the social sciences in regulatory theories, thereby widening the discussions with elements of the economic system to link emotions into that system.[71] "Implicitly or explicitly, the use of regulatory tools and strategies by a regulator to alter the behaviour of regulatees is dominated by the assumption of rationality"; however, that may not always be the case.[72] New theories suggest that in order to persuade an organization to comply with regulation, it may be more effective to use an emotional stick rather than a rational penalty. That emotional stick could be stripping the organization of its intellectual property rights for example.[73] Emotions may also play a large role in elements such as political risk and the cultural norms held by the government of the day, or how the collective may react to an external event. The population of some jurisdictions can be much more emotionally charged than others.[74]

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[67] Faux, above n 48, 6.
[68] Baldwin et al, above n 1, 160.
[69] *Hospital and Health Boards Act 2011* (Qld) s4.
[70] AMA, *Mission Statement* Australian Medical Association < https://ama.com.au/article/ama-mission-statement>.
[71] See Goldie, P 2000. *Emotions: A Philosophical Exploration*. Oxford: Clarendon Press; Helliwell, JF, Layard, R and Sachs, J (eds) 2015. *World Happiness Report 2015*. New York: Sustainable Development Solutions Network.
[72] Drahos and Krygier, above n 4, 9.
[73] Ibid.
[74] Frijda, NH, Manstead, ASR and Bem, S (eds) 2000. *Emotions and Beliefs: How Feelings Influence Thoughts*. Cambridge: Cambridge University Press.

The above sections have considered regulatory theory in a general sense, providing an overview of the forms of regulation that will be discussed in this thesis. However, it is also necessary to consider the regulatory theory specifically surrounding the consumer.

2.5 Regulation and the Consumer

The field of consumer law is not itself a Priestly 11[75] requirement within the study of law. At law, consumers were not really recognized until the beginning of the industrial revolution when citizens moved to the cities to work in large factories and were no longer providing for themselves. Until that time there were basic disciplines including contract law, commercial law, administrative law, tort law, criminal law and civil law.[76] Consumer law has not become a new arm of legal studies as such, but rather, it is derived "from the specificity of the way in which it obliges one to evaluate the legal phenomena dealt with within the existing disciplines"… "It deals with legal situations in which citizens find themselves as a newly recognized subject: the consumer".[77] Goldring[78] goes further and suggests that at least everyone in the developed world is a consumer.

> They depend on goods and services provided by others. Consumer law, then, is the body of law which governs or affects their position as the users of goods and services provided by others. Wherever there are people and commodities, there are consumers, and in any society, there are also rules which govern their rights and obligations.

If everyone is a consumer then should it be necessary to define a consumer? Goldring suggests that the definition of a *consumer* should not be based on those who should be excluded, such as businesses; nor for the purpose for which products and services are used; a price discriminator may be closer but not precise. "A real distinction between those who need the protection of the

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[75] Victorian Legal Admissions Board, *Qualifications and Training: Academic* (29 March 2021) Supreme Court of Victoria <https://www.lawadmissions.vic.gov.au/qualifications-and-training/academic>.
[76] Thierry Bourgoignie, 'Characteristics of Consumer Law' (1992) 14 *Journal of Consumer Policy* 293, 294.
[77] Ibid.
[78] John Goldring, 'Consumer Law and Legal Theory: Reflections of a Common Lawyer' (1990) 13 *Journal of Consumer Policy* 113, 115.

law and those who do not is based on their relative power".[79] Furthermore, consumption is more than the decimation of products and the use of services. Existence of those products and services:[80]

> involves a conglomerate of producers: designers, market researchers, inventors, producers of components, assemblers, distributors, transporters, marketers and advertisers before the product reaches the point of retail sale. Thus the single consumer is often faced with a vast enterprise, with substantial collective power and resources. This gives rise to a power imbalance…

The main body of law that was changed in an attempt to counter that imbalance was contract law. The historic principles of contract law include freedom of contract and equal bargaining between parties, and yet legislative intervention has altered these principles in the guise of consumer law. These changes are in fact latecomers to those that went before them in such areas as landlord and tenant, family law and labour law.[81] The concern in this section however, is the regulatory theory that has resulted as a consequence of these changes in laws for the benefit and protection of consumers.

A key point by Goldring, which explains the underlying need for change as determined by this thesis, is:[82]

> Consumer law is probably equally as necessary in a centrally planned economy as it is in unbridled "free-market" capitalism, because systems operated by humans will never be perfect. Consumer law, as defined here, exists because of those imperfections: to prevent them or to provide compensation for loss or damage suffered as a result of those imperfections.

This thesis seeks to provide a mechanism of compensation for consumers who suffer detriment due to the failing of companies, which are ultimately always operated by humans.

2.5.1 Interventionist Theories

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[79] Ibid 116.
[80] Ibid 117.
[81] Iain Ramsay, 'Consumer Law and Structures of Thought: A Comment' (1993) 16 *Journal of Consumer Policy* 79, 81.
[82] Goldring, above n 60, 129.

Norbert Reich[83] was a prolific commentator on the subject of consumer law and consumer aspects within Germany and the European Union. Reich described three distinct phases in consumer protection philosophy: *pre-interventionist, interventionist, and post-interventionist.*[84]

Reich dated the pre-interventionist events to the 1950s and 60s and suggested there were 'mild' solutions with regards to consumer protection. Those solutions imposed content-related standards into contract law, and along with remedies against deception and misrepresentation, made it more effective. In terms of contract 'balance of bargaining power' these measures, along with greater information in the form of better product labeling and self-help systems, all contributed to greater power to the consumer. Alongside these measures was the encouragement of competition within the market place to ultimately provide consumers with greater product selection and hopefully lower prices.[85]

In the 1970s the nations of the world began to regulate more heavily, becoming *interventionist*. In Australia, the Trade Practices Act[86] was a major advance in consumer protection with the recognition of the consumers' right to product safety[87], which balanced out the bargaining power through statutory sections such as 'false or misleading conduct'[88] and 'false or misleading representations'[89], along with others included in Part V titled Consumer Protection. In respect of the European Union, the single marketplace was in major development and constant Directives were being generated by the European Commission to manage the collective of Member countries.

The *post-interventionist* stage, according to Reich, was a reaction to the large amount of legislation being generated, critically claiming it was inefficient and at times had failed to regulate as desired. This later stage was marked by an increase in the amount of information that consumers could discover, and manufacturers were to provide, making the power balance much closer again.

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[83] Hans W Micklitz, 'Norbert Reich, Founder and Pioneer of Consumer Law 1937–2015—Obituary' (2015) 39(1) (March 2016) *Journal of Consumer Policy* 3.
[84] Norbert Reich, 'Diverse Approaches to Consumer Protection Philosophy' (1992) 14 *Journal of Consumer Policy* 257.
[85] Ibid 258.
[86] *Trade Practices Act 1974* (Cth).
[87] *Trade Practices Act 1974* (Cth) Part VA.
[88] *Trade Practices Act 1974* (Cth) s52.
[89] *Trade Practices Act 1974* (Cth) s53.

The other change that Reich discussed was the introduction of Self-regulation as a softer method of regulating (see discussion at 2.4.4).[90]

2.5.2 Collective Consumer Action

Another concept that Reich, and separately Thierry Bourgoignie[91], considered was that of consumers banding together to bargain with manufacturers and suppliers. Loosely based on the concepts of labour unions and co-operatives, whilst the theory conceptualizes groups of consumers bargaining with manufacturers for the benefit of all consumers, there were some drawbacks, mostly due to the individual nature of each consumer. For example, a group of consumers interested in washing machines will not necessarily be the same as a group interested in motor vehicles. Reich believed that the consumer would fight for a cause to a limited extent, but mainly for their own interest.[92] However, the important message from Bourgoignie is this:

> There is no doubt that the collective dimension of consumer law constitutes one of its most important features. It imprints on consumer law its true aim. While the goal is, certainly, to change the conditions under which relations between the professional and the consumer develop, this objective must be perceived in the wider context of reassessment of the role and power of consumers as a group vis-a-vis the other economic agents and establishment of an effective countervailing power of consumers within the overall economic order.
>
> *The collective nature of the legal model of consumer law must evidently influence the choice of instruments and rules to be developed for the benefit of consumers*[93] (emphasis added).

Bourgoignie concluded by suggesting that each consumer area of interest should be considered individually in terms of the chosen instrument whilst disregarding the socio-economic status of the individuals or the group. "Otherwise, consumer law would become a new cause of social inequality".[94]

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[90] Reich, above n 66, 267.
[91] Bourgoignie, above n 58.
[92] Reich, above n 66, 280.
[93] Bourgoignie, above n 58, 299.
[94] Ibid 301.

These views are reinforced by Goldring who also suggested that “consumer law, by its nature, requires the intervention of the state, and cannot be left to individual actions”.[95]

2.5.3 No Consumer Law Theory

Michael Ferry, a practicing lawyer in the USA, specializing in the field of Consumer Law, wrote a paper contradicting much of the above.[96] His paper suggested “the concept of "theory" has no true application to the field of consumer law”. There are several components to his article that are relevant here. Firstly, Ferry opined that the best way to understand consumer laws and how they should operate was to consider the source of the legislation itself including the nature of the political party, the goals that were to be met, and the motivation for development of the legislation. These elements actually exist within theories already discussed in 2.3 and therefore, by gathering the information he suggests, one could develop an analysis of how the legislation may work. The second point is that Ferry uses a number of examples where then existing legislation had potentially failed the consumer. However, the sample consumers in his study were either unable to read, didn’t bother to read the paperwork before signing, did read the paperwork and understood its implications but did “not have the economic power to translate [their] knowledge into effective self-protection”, or had no real choice due to their economic situation.[97] In the situations described the seller had provided the disclosure required at the time and was not operating against the law. However, Ferry claims that:[98]

> Such consumers become victims of predatory behavior because they lack the power to make a meaningful choice. These people may have full understanding of what is being done to them. Their understanding will not protect them. They are not standing in the middle of the track as the onrushing train bears down on them; they are standing in the middle of the tunnel. They have no place to go.

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[95] Goldring, above n 60, 130.
[96] Michael Ferry, 'Theory vs. Practice in Consumer Law: An Advocate's Perspective' (1992) 14 *Journal of Consumer Policy* 317.
[97] Ibid 325-326.
[98] Ibid.

Ferry advocates for laws that regulate activity, however it would seem that regardless of what regulation was to be in place, this group of consumers would be no better off if the seller does not comply. Ramsay[99] referred to Ferry's paper and claimed that:

> his approach may have significant undercurrents of victim blaming and consequently this approach will fail either to empower or to provide any significant critique of consumer capitalism and the nature of its selling practices.

This further confirms Bourgoignie's opinion that consumer law should not be a new cause for social inequality (2.5.2). The issue raised by this thesis is not about social inequality and the solution offered will be limited to protecting only those who are caused financial detriment due to a company ceasing to trade.

2.5.4 Self-regulation – Consumer Markets

Although slightly dated, the report prepared by the Taskforce on Industry Self-regulation [100] regarding Industry Self-regulation in Consumer Markets, presented in August 2000, is still the current point of reference on that topic for the Australian Government. At the time, a stated objective of the Government was to lower regulatory costs and improve market outcomes for consumers. Additionally, the Government claimed that industry should take greater responsibility and ownership for developing effective self-regulation.[101] However, the report suggests that self-regulation may not be an appropriate form of regulation where there is a high risk of serious or widespread harm to consumers. This point is not quantifiable currently as consumer detriment caused by a company ceasing to trade is not measured (see 2.7). The Taskforce also considered that self-regulation was suitable where there were clearly defined problems.[102] The size and nature of an industry also has a bearing on whether self-regulation would be effective. A cohesive industry where participants are willing to invest financially in embracing the values and

[99] Ramsay, above n 63, 91.
[100] Taskforce on Industry Self-regulation, above n 43.
[101] Ibid 1.
[102] Ibid 45.

code of practice within the industry would be more suitable. This may reflect a competitive industry where members may strive to achieve and exceed self-imposed standards to create a competitive edge.[103] Market incentives, being either greater market share or sanctions, may also ensure that non-participants in the scheme do not receive any benefits for escaping compliance costs.

The clear message from these guidelines is that to impose any regulatory measures through self-regulation to resolve the problems posed by this thesis would not necessarily provide a successful outcome across all industry groups. The ultimate result therefore would be that not all consumers would be sufficiently covered, which must be considered in the final solution.

2.6 Theories relating to detriment, or financial harm

When a company ceases to trade and there are consumers left with Active Entitlements, those consumers may be caused detriment or financial harm if they have to pay extra for something for which they had already paid. The theories of harm are presented here to validate the need to protect society and its members from harm. The development of civil society over time has increased the desire of the group as a whole to reduce harm to its members, not only physical harm but also social harm. The values and expectations of, and from, our societies today, and indeed most Western societies, are vastly different than those of our forefathers.[104] From the signing of the Magna Carta, to the development of the Bill of Rights in the UK, to the constitution of the USA, and that of Australia, it has been a long and winding road for modern people.[105] Even for philosophers such as Plato and Aristotle, ethics and morality were subjects that were of concern to society.[106] The development of 'civil society' has been a more modern achievement and the development of rights for individuals has been an established part of that

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[103] Christine Parker, *The Open Corporation: Effective Self-Regulation and Democracy* (Cambridge University Press, Melbourne, 2002).
[104] Francis Fukuyama , 'Social capital, civil society and development' (2010) 22 *Third World Quarterly* 7.
[105] Ibid.
[106] Olga Savage and Brian Pratt, 'The history of UK civil society' (Intrac, 2013).

journey. The organisation of society and communities has been the study of sociologists who have developed several key theories in an attempt to explain that organisation.[107]

As one delves into the detail of the organisation of societies, one may find many intricate components some would call functions, some would call actors, and others may call elements.[108] One of those elements is harm to society, where actors may cause detriment to others. An actor may be an individual, a group or an organisation. Common harm would notably be called a crime, generally where someone physically or mentally harms another person or persons. Other harms may be social or economic. Any of those harms could then be distinguished by its relativity to some sort of standard, making some harms worse than others.[109]

And whilst society would place a clear set of moral and ethical standards on individuals within the civil society, so too in the modern society are standards of ethics and morality imposed on the organisations that service the civil society.[110] The concern of this thesis is the economic harm caused to individuals by organisations that may not consider the value of good ethics and morals within today's society.[111] In a capitalist society it is a fine balance for the elected government to encourage development of businesses whilst protecting consumers. The goal of this thesis is to protect consumers from harm, regardless of how the elected government manages the activities of business.

2.6.1 Development of 'civil society'

In early known civilisations, for centuries there was generally a ruler, a king, a queen, a despot, a tyrant or some other leader who made the rules and led the weaker common person who served at the mercy of that leader. In the Middle Ages in the United Kingdom (UK) various kings ruled the land, creating

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[107] Christoph Spurk, 'Understanding Civil Society - History, debates, and contemporary approaches' (2008) < https://www.researchgate.net/publication/264885895>.
[108] Ibid.
[109] Ibid.
[110] Malcolm K Sparrow, *The Character of Harms: Operational Challenges in Control* (Cambridge University Press, 2008).
[111] Ibid.

laws, deciding when to head to a war, and committing many people's lives to the king's wishes.[112] At the time of King John the many wealthy and somewhat powerful landowners of the country decided that the king should not be above the laws of the land, even if he make the laws. The original Magna Carta was signed in 1215 and re-signed by subsequent monarchs with various amendments.[113] The development and redevelopment of the Magna Carta was the beginning of what is known today as democracy, where the people have a say in what the governing people will do. This evolution of a civil society brought about the notions of protecting the individual and their property and rights from the state.[114]

2.6.2 Social Theories

There were many writers and activists in the 17th and 18th centuries who had varying opinions about how the civil society worked. Karl Marx for instance considered that a civil society would only work in conjunction with the bourgeoisie[115], whereas Friederich Hegel saw civil society as a product of 'economic modernisation' and as comprised of a number of 'actors' "like the market economy, social classes (including the bourgeoisie), corporations, intellectuals, and civil servants – all societal actors not directly dependent on the state apparatus".[116] Charles Montesquieu considered a model of separation of powers, which distinguished "between political society (regulating the relations between citizens and government) and civil society (regulating the relations between citizens)".[117] In the 20th century Jurgen Habermas considered that civil society played a significant role in the communications process in the public sphere. "In this understanding, the political system (state, government, and political society) needs the articulation of interests in the public space to put different concerns on the political agenda. Usually it would be established institutions such as political

[112] Savage and Pratt, above n 85, 2.
[113] Ibid.
[114] Spurk, above n 86.
[115] Ibid, 2.
[116] Ibid.
[117] Ibid.

parties that would perform this articulation". Habermas also suggested that there must be further communication from 'beyond the established power structures' where people can organize themselves into "marginalized groups as a means to articulate their interests".[118] In the times of the Magna Carta it was the elites of the country who demanded civil rights. In more recent times the marginalized groups have found a voice and demand participation in social welfare and political activism, and even more recently women's liberation, voting for women, environmental awareness and general equality.[119] Another well-known writer, Adam Ferguson, wrote a book called *An Essay on the History of Civil Society* which "was to describe civil society in terms of *the people;* that is, as arising through the gradual evolution of a way of life, which we have come to call a culture. With Ferguson, civil society described the culture of a people, and was no longer a synonym for political society or the state".[120]

In contrast, other writers have dissected the term 'civil society' in slightly more micro terms. Norbert Elias "interprets civilisation as a process in which individuals gradually channel, control and moderate their emotions, affects and desires".[121] Elias asserted that civility was the result of self-discipline and was ultimately reduced to etiquette or good manners. Adam Smith saw a softer or more empathetic approach and suggested that people gathered in groups based upon their compassion, which was a popular theory amongst religious congregations and secular philosophers.[122] The theory of justice as the basis for a civil society was offered by John Rawls,[123] and stresses the aspect of fairness. "The concept of justice for modern societies must take the fact that people have different goals and different ideas about the 'good life' into account. Hence, justice has a primacy over personal beliefs. Also the state should remain neutral vis-a-vis such subjective interpretations of the

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[118] Ibid, 3.
[119] Ibid, 6.
[120] Boris DeWiel, 'A Conceptual History of Civil Society: From Greek Beginnings to the End of Marx' (1997) 6 *Past Imperfect History & Classics Graduate Student Journal, University of Alberta* 3, 24.
[121] Dieter Rucht, 'Civil society and civility in twentieth-century theorising' (2011) 18(3) *European Review of History: Revue europeenne d'histoire* 387, 394.
[122] Ibid.
[123] John Rawls, *A Theory of Justice* (Harvard University Press, 1971).

'good'".[124] Rawls saw that justice was composed of two principles: First Principle: each person is to have an equal right to the most extensive total system of equal basic liberties compatible with a similar system of liberty for all. Second Principle: social and economic inequalities are to be arranged so that they are both: (a) to the greatest benefit of the least advantaged, consistent with the just savings principle, and (b) attached to offices and positions open to all under conditions of fair equality of opportunity".[125] An observer could suggest that this theory is highly idealistic and clearly not a complete picture of civil society.

Modern day sociologists have developed theories that more broadly describe how society operates. The first of three main theories considers society as an interconnected system of functions "that work together in harmony to maintain a state of balance and social equilibrium for the whole".[126] A *functionalist perspective* suggests that there are several social institutions such as 'family', which provides the reproductive, nurturing and socializing of children aspect; 'education', which offers a way to pass on skills, knowledge and culture to the next generation; 'politics', which provides a means of governing; and 'economics', which contributes the marketplace, manufacturing and consumption of goods, whilst 'religion' provides an outlet for worship. As an example of explaining how these interconnected elements work, if the number of parents assisting with children's schoolwork were to decrease, the number of children likely to fail at school would increase. Also, "the increasing number of women in the workforce has contributed to the formulation of policies against sexual harassment and job discrimination".[127] Elements of a civil society can be functional if they contribute to the wellbeing of the society whilst others may be dysfunctional. Crime can be seen as dysfunctional as it is associated with violence. "But according to Durkheim and other functionalists, crime is also functional for society because it leads to

[124] Ibid, 395.
[125] Ibid.
[126] Mooney, Knox and Schact, 'The Three Main Sociological Perspectives' in *Understanding Social Problems* (5th ed, 2007) .
[127] Ibid.

heightened awareness of shared moral bonds and increased social cohesion".[128]

In contrast to the functionalist perspective, the "conflict perspective explains various aspects of our social world by looking at which groups have power and benefit from a particular social arrangement".[129] This view found its base in the works of Karl Marx[130] and suggests there is a division in society between the upper class, or owners (bourgeoisie), and the working class (proletariat). The owners control the major institutions of society and regulate how society works. Even religion "serves as an 'opiate of the masses'" and "diverts the workers so that they concentrate on being rewarded in heaven for living a moral life rather than on questioning their exploitation".[131]

The functionalist perspective and the conflict perspective are both seen as macro-sociological theories. The third perspective considers micro-sociology and is called the symbolic interactionist perspective; it analyses definitions and meanings of social behavior and its consequences. It has been suggested that "humans respond to their definition of a situation rather than to the objective situation itself" and "that situations that we define as real become real in their consequences".[132] The reality for consumers who lose the value of active entitlements when a company ceases to trade is the consequence that they are forced to spend more money again to obtain those same entitlements.

2.6.3 Social Harm

As the functionalists propose, crime is a dysfunctional element of society. Alternatively, "crime in many different sets of relationships serves to maintain existing power relations"[133], which tends towards the conflict perspective. Hillyard and Tombs argue that those who make the criminal laws, parliamentarians, have the potential and opportunity to capture the harmful

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[128] Ibid.
[129] Ibid.
[130] David Collins, *Organisational Change: Sociological Perspectives* (Routledge, 2005), 157.
[131] Mooney, above n 124.
[132] Ibid.
[133] Paddy Hillyard and Steve Tombs, 'From 'crime' to social harm?' (2007) 48(1-2) *Crime, Law and Social Change* 9, 15.

events within high-powered corridors of state and commerce, yet they focus on "individual acts and behaviours on the streets".[134] They further suggest that this focus on the individual quietly sanctions ignorance of the wider issues that cause the greater harm of poverty, social deprivation and the widening gap between the poor and the rich. Additionally, corporate interests increasingly see crime as an opportunity to increase business and therefore promote anything that may be socially unacceptable as a crime to increase their own business. Politicians also use crime "to mobilise support both for their own ends and to maintain electoral support for their parties".[135]

The term 'social harm' has been touted and much discussed in the early twenty-first century.[136] The general discussion of harm has historically related to crime and its study based in criminology.[137] It is suggested that the potential field of 'social harm' could be "a disciplinary home which could embrace a range of harms that affect many people throughout their life cycle... encompassing the deleterious activities of local and national states and of corporations upon peoples' lives, whether in respect of lack of wholesome food, inadequate housing or heating, low income, exposure to various forms of danger, violations of basic human rights, and victimisation to various forms of crime".[138] Hillyard and Tombs have considered a number of sections within 'social harm' to categorise the broad number of elements. Certainly the current field of crime and criminology would exist in one category. Another category could be *financial and economic harm* ensuing from property or cash loss, which could result from fraud, "misappropriation of funds by government, private corporations and private individuals, increased prices for goods and services through cartelisation and price-fixing, and

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134 Ibid.

135 Ibid, 16.

136 See for example Paddy Hillyard et al, *Beyond Criminology: Taking Harm Seriously* (Pluto Press, 2004); Simon Pemberton, 'Social harm future(s): exploring the potential of the social harm approach' (2007) 48(1-2) *Crime, Law and Social Change* 27; Hillyard and Tombs, above n 106; Kristian Lasslett, 'Crime or social harm? A dialectical perspective' (2010) 54(1) *Crime, Law and Social Change* 1.

137 Malcolm K Sparrow, *Handcuffed: What's the Primary Goal of Policing?* (Brookings Institution Press, 2016).

138 Hillyard and Tombs, above n 109, 16.

redistribution of wealth and income from the poorer to the richer through regressive taxation and welfare policies".[139]

Whilst views are at times at odds with each other, it is generally agreed that the development of the field of criminology has advanced significantly over time and has provided a depth of knowledge for those involved in the prevention and policing of crime. Also agreed is that the development of the 'social harm' field, and indeed the sub-categories other than crime, would be well served by "the work of investigative journalists, human rights activists, and other critical scholars".[140] Pemberton further suggests that there are actions and activities that create harm but those harms may be caused by the indifference of either social groups or indeed corporations. Furthermore, "bystanders do not possess the power to prevent the harms produced by social organization and cannot be viewed as responsible".[141] The development of [142]

> the social harm perspective must seek to create 'aetiologies of harm production' which take into account harms that result from both intention and indifference. Often an erroneous moral distinction is drawn between the two, which assumes that acts of indifference are not 'morally comparable' to those of intent. On the contrary, I argued, acts of indifference are 'morally comparable' if an individual or group are demonstrated to have been capable of intervening. Thus, whether harm occurs from intent or indifference is morally irrelevant when the results of both have been identified to be preventable.

Of specific relevance to this thesis, Pemberton further discusses the critical issue of harm caused by corporations, with "complex divisions of labor, and consequently the harms that corporations produce encompass large chains of decision-making and actions".[143] He suggests that the social harm perspective must endeavor to allocate responsibility, which has been addressed to some degree by the criminology point of view. The laws within the *Competition and Consumer Act 2010* (Cth) are an example of that approach, confirming the

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[139] Ibid, 17.
[140] Pemberton, above n 112, 29.
[141] Ibid, 38.
[142] Ibid.
[143] Ibid, 39.

evidence of numerous studies that "management decisions have been shown to be instrumental within the production of specific harms". [144]

Lasslett[145] has a slightly different perspective on social harm and considers that "social harms arise when socially generated processes undermine the organic reproduction of 'man', or the organic/inorganic reproduction of man's environment". Lasslett has also suggested that others refer to social harms as relative to a set of norms or an 'ethical concept of man' and that a social harm is therefore something that is *unjust*.

2.6.4 What is harm?

The following discussion illustrates that harm can be a number of things and can also be a relative term. Ultimately, it will be seen that a consumer, who loses the value of their active entitlements at the time a company ceases to trade, is directly caused harm by the action of the company ceasing to trade. The examples provided were those of the theorists concerned.

"According to one specification of harm, a person P is harmed by an act (or an event) *a* iff (sic), as a result of *a*, P is made worse off in terms of well-being".[146] This scenario would clearly describe the situation where a person has been murdered or has been occasioned grievous bodily harm. The term 'worse off' is one that requires further clarification, but when a life is lost by the action of another, the loss of life is clearly a 'worse off' situation. Indeed, both the terms 'worse off' and 'well-being' are quite relative terms. Therefore a baseline measurement must be included to consider the value of 'well-being' and how much 'worse off' one can be in a scenario. The argument by Petersen is that there may be various baselines and those variations will offer variations in the value of 'worse off' and also give conflicting views as to whether an act is harmful or not.[147]

The *temporal baselin*e is a concept that considers whether a person's well-being is lower after a harmful action than immediately prior to the action.

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144 Ibid.

145 Lasslett, above n 112.

146 Thomas Søbirk Petersen, 'Being Worse Off: But in Comparison with What? On the Baseline Problem of Harm and the Harm Principle' (2014) 20(2) *Res Publica* 199.

147 Ibid, 201.

Again, one can consider the actions of murder or rape to be harmful as the person's well-being would be lower after the action. A hypothetical scenario suggests that this is not always the case in every situation…[148]

> *The Headache*
>
> Julia has had a terrible headache for eight days. Although Julia is not aware of this, the headache is about to stop. Just before the moment in time when it will stop by itself, Julia orders a glass of water in a bar. Peter, the bartender who serves Julia, adds a drug to the glass of water he hands over to Julia. The drug causes Julia's headache to continue for another eight days. Had Peter not added the drug to the water, Julia's headache would have ended at the time the drug was absorbed and acted on Julia. And this is true because Peter would then just have served Julia a glass of pure water.

In this scenario the action of the bartender does not make Julia worse off than immediately prior to her consuming the drug, but nevertheless, Peter has harmed her by continuing her headache. The baseline could be altered to consider Julia's average wellbeing over a period of time and, assuming she does not normally have headaches, this could then impose the harmful action to also lowering Julia's wellbeing. Another scenario counters that baseline theory…[149]

> *The Chronic Disease*
>
> Suppose Paul has always been in severe pain with a chronic disease, but that suddenly one day his pain is about to stop. But then again Peter steps in, out of the blue, and just before the moment in time before Paul's pain about to stop Peter injects Paul with a toxic substance that will make Paul suffer from a new chronic disease. Although the new chronic disease is painful, it is not quite as painful as the old chronic disease of Paul's.

In this scenario it could be said that Paul is not worse off after the action of Peter as he has in fact less pain that in the past. However it would seem wrong to suggest that Peter has not harmed Paul. Another alternate baseline could be the average wellbeing of humankind. Petersen considers that this measure could be *relative* – the average wellbeing of humankind at a time in history, or objective – "the baseline may be a rigid designator that will refer to

[148] Ibid, 204.
[149] Ibid.

the same level of well-being in all possible worlds".[150] These baselines too cause problems if the 'victim' happens to be well above the average baseline chosen and the harm caused to them brings them down to the average.

The *counterfactual baseline* theory is another alternative and proposes that:[151]

> The counterfactual baseline (CB)
>
> Individual P1 is harmed by P2 iff: by doing (or allowing) act *a*, P2 brings it about that P1 is worse off in terms of well-being than P1 would have been in the absence of *a*.

This theory provides a 'true' answer to both of the example scenarios.

Putting these scenarios into perspective with the topic of this thesis and using the counterfactual baseline, it could well be implied that a consumer, with active entitlements, can be harmed by a company if: by the company becoming insolvent (and subsequent liquidation), the company brings about a situation where the consumer is worse off in terms of wellbeing than the consumer would have been in the absence of the insolvency proceedings. It is therefore crucial to understand how companies actually get to the point of insolvency, and how decisions are made, as well as the focus of those decisions.

2.6.5 Business ethics

Companies, both private and public, are governed by many laws that provide a minimum set of standards and guidelines under which they should operate.[152] Ultimately companies are artificial entities created to allow multiple people to work for a common goal, and companies are driven and directed by people. Decisions made by a company are clearly made by the people responsible for operating the company who understand the laws described above. The decision makers are also bound by a sometimes written, and sometimes unwritten, code of ethics. It is considered that business ethics "draws from a variety of disciplines, including ethics, political philosophy, economics, psychology, law, and public policy. This is because remedies for

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[150] Ibid, 205.
[151] Ibid, 207.
[152] For example in Australia *Corporations Act 2001* (Cth); in USA Sarbanes-Oxley Act of 2002; in EU Directive 2005/56/EC.

unethical behavior in business can take various forms, from exhortations directed at private individuals to change their behavior to new laws, policies, and regulations".[153]

'Shareholder primacy' and 'stakeholder theory' are two main views that describe the reason for the company's being. The first has the shareholders see themselves as owners of the company and every action by the company should be for the beneficial interest of those shareholders.[154] Most companies either make, or purchase, goods and/or services and sell them for a profit, and the goal of the shareholders is to maximize profit.[155] An alternative view is that a company should operate in the best interest of all stakeholders, where a 'stakeholder' is any person or entity that has an interest in the ongoing wellbeing of the company.[156] Stakeholders can include the shareholders, suppliers, customers, employees and the community. Indeed, in the modern world, managers of businesses are being asked to 'balance' the interests of all stakeholders. The latter view being a more considered view,[157] it offers a more sustainable enterprise where the first view will be satisfied on a more long term basis rather than just by itself.[158]

The balancing act required of company directors thus brings with it many ethical and moral dilemmas.[159] Including the community as a stakeholder invites the environment into the conversation and thus the modern dilemma, for instance, for power stations of whether to burn coal, use nuclear power or use replaceable energy sources such as wind and solar.[160] Of course governments can have an influence on these dilemmas through regulation. Here the community can have further influence on regulation by the use of 'people power' to show that a certain decision is either ethically or morally

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153 Jeffrey Moriarty, 'Business Ethics' in Edward N Zalta (ed), *The Stanford Encyclopedia of Philosophy* (Fall ed, 2017) .
154 Mark J. Loewenstein and Jay Geyer, 'Shareholder Primacy and the Moral Obligation of Directors' (2021) 26 *Fordham Journal of Corporate & Finance Law* 105.
155 Moriarty, above n 133.
156 Josh Kaler, 'Evaluating Stakeholder Theory (2006) 69 *Journal of Business Ethics* 249.
157 Robert Freeman, J Harrison, & S Zyglidopoulos, *Stakeholder Theory: Concepts and Strategies (Elements in Organization Theory)* (Cambridge University Press, 2018).
158 Moriarty, above n 133.
159 Yotam Lurie and Robert Albin, 'Moral Dilemmas in Business Ethics: From Decision Procedures to Edifying Perspectives' (2007) 71 *Journal of Business Ethics* 195.
160 Ibid.

undesirable such as the proposed dam on the Franklin River in Tasmania.[161] Other issues, such as what goods or services should be available, are ethical or moral dilemmas. It can be argued that sexual services, surrogacy services and the purchase of human organs may not be desirable practices.[162]

The sale of some or all of these goods and services can be ethically or morally right or wrong in different countries and cultures. This highlights a further dilemma for companies that wish to expand their offerings beyond their source countries.[163] Multi-national companies may choose, for good economic reasons, to have their products manufactured in another country. Should the company continue to enforce the same code of ethics in the new country or 'respect' the morals and ethics of the new country? Staying with the former would see workers being paid very low wages which, when exposed (as can happen quite quickly on social media), can be bad publicity for the company.[164] Working conditions and facilities can also be dangerous such as the Rana Plaza collapse in Bangladesh in 2013, which killed hundreds of workers.[165] Again that event was bad publicity for the company(s) involved, costing them sales, at least in the short term. However, alternative actions, such as comparable wage structures and higher standards of building practices, would reduce the attractiveness of the option to manufacture elsewhere, hence creating a further dilemma.[166]

One of the many ways that companies expand their operations is through the use of credit. Credit became a new product early in the Industrial Revolution[167] and has been used voluminously ever since. In the 1980s there were many 'high-flyers'[168] who took advantage of high asset values and leveraged high levels of debt. Along with the high levels of corporate debt there also appeared to be a high level of social pleasure experienced by the

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161 *Commonwealth v Tasmania* (1983) 158 CLR 1.

162 Nigel Piercy and Nikala Lane, 'Ethical and Moral Dilemmas Associated with Strategic Relationships between Business-to-Business Buyers and Sellers' (2007) 72 *Journal of Business Ethics* 87.

163 Ibid.

164 Yotam Lurie and Robert Albin, above n 157.

165 Laurent Bossavie et al, 'The Effects of International Scrutiny on Manufacturing Workers: Evidence from the Rana Plaza Collapse in Bangladesh' (Policy Research Working Paper No 9065, World Bank, 22 Nov 2019).

166 Moriarty, above n 128.

167 Sir Gordon Borrie (ed), *The Development Of Consumer Law And Policy - Bold Spirits And Timorous Souls* (Stevens & Sons, 1984).

168 For example Alan Bond and Christopher Skase in Australia.

entrepreneurs and colleagues "who [were] unashamed to indulge openly in luxuries, and use[d] borrowed money more than [was] customary to finance their business or lifestyle, or both".[169] Due to the relatively few people who acted in this manner there was a measure of community displeasure. Furthermore, "what makes moral indignation especially tempting is that their lifestyle seems miraculously to survive bankruptcy".[170] However Kilpi would urge that[171]

> As a social and economic phenomenon credit is a useful form of human activity, which rests on the right of autonomous people to engage in voluntary transactions of wealth. The fact that the level of debt is high does not warrant moral censure, nor does an occasional default, which should be seen as an undesirable but inevitable side effect of a beneficial practice.

This extreme example leads back to the discussion of the end-game of the company and whether it should be for the sole satisfaction of the shareholder(s) or all stakeholders.

Large companies have had to make some serious decisions that have seen the company either survive, if only just, or not at all. In the early 1970s the Ford motor company in the USA planned and manufactured a new vehicle, the Pinto, for the local market to compete against foreign competition.[172] The president of the company was very insistent that the production schedule should stay on budget and on time, clearly for economic reasons. Internal testing had shown however that there was a potential fault with the fuel tank which could rupture from a rear-end collision. The president was faced with two issues: company viability and customer safety.[173] From the 'all stakeholder' perspective, the decision-maker faced the ethical issues of being honest with the consumer public about the known fault, risking staff employment, continued business for component suppliers and value for the shareholders. The business risk was accepted and the Pinto was released for

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[169] Jukka Kilpi, 'Gearing Up, Crashing Loud. Should We Punish High-flyers for Insolvency?' (1996) 15 *Journal of Business Ethics* 1343.
[170] Ibid 1347.
[171] Ibid 1344.
[172] Patrick Maclagan, 'Varieties of Moral Issue and Dilemma: A Framework for the Analysis of Case Material in Business Ethics Education' (2003) 48 *Journal of Business Ethics* 21, 28.
[173] Ibid.

sale. Subsequent fires in the car were dismissed as consequential of people and road conditions rather than design flaws.[174]

One possible explanation for the action of the decision-maker, other than the self-interest goal of shareholders, is that "business ethics is understood as an optional supplementary to the knowledge of business management". [175] Aasland suggests that as long as the company appears to be ethical, it will be in the eyes of all stakeholders. Furthering shareholder primacy he also puts forward that there is a[176]

> paradox of business ethics: The only viable way for responsibility (or ethics) as a means of achieving a given goal (here: a maximum profit), is to make responsibility (or ethics) into a goal in itself. But this would mean a substitution of the profit goal with a goal of responsibility, a substitution that would be unacceptable from a profit maximizing point of view.

When analyzing the Finnish retail market, Takala and Uusitalo[177] make an even greater distinction between general ethics and business. They suggest that professionals in business, such as marketers or senior managers generally, all deal with ethically problematic issues; however, their virtues are "probably different from general virtues".[178] This means that they have certain skills and talents, which allow them to perform their tasks and professional roles well. They then suggest that this also develops a "gap between general moral considerations and the professional duties and values…Professional virtues may be different from general virtues (like honesty, fairness, impartiality etc.), and may still be justifiable through the goals they serve. Some provocative examples: business defies honesty by selling poison; advertising produces blatant lies, distorts reality and creates artificial needs to make profit for a firm. A used car salesman must be a professional liar to succeed in his business".[179] Additionally, not to necessarily suggest that those

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174 Ibid.
175 Dag G Aasland, 'On the Ethics Behind "Business Ethics"' (2004) 53 *Journal of Business Ethics* 3, 4.
176 Ibid.
177 Tuomo Takala and Outi Uusitalo, 'Finnish Retailing Business' (1995) 14 *Journal of Business Ethics* 893, 896.
178 Ibid.
179 Ibid.

virtues are right or wrong, they ask some basic questions which any businessperson could ask.[180]

Does action A violate the law?

Does Action A violate any general moral obligations:

- duties of fidelity?
- duties of gratitude?
- duties of justice?
- duties of beneficence?
- duties of self-improvement?
- duties of non-maleficence?

A negative response to these questions provides the decision-maker who shares the 'shareholder primacy' with a positive as not having to address these issues saves money and thus greater benefit for the shareholder. But where would that firm be today with the call for Corporate Social Responsibility (CSR)? A company showing a CSR typically makes actions that are not legally required and may economically benefit parties other than the corporation (however there will be a return in some beneficial form).[181] There are suggestions by a number of scholars[182] that there is a positive correlation between corporate social responsibility and corporate financial performance, which also supports sustainability. This would therefore suggest that moving from 'shareholder primacy' towards the 'stakeholder theory' might be beneficial to both the organisation and society as a whole. There is a caution, however, that to rely upon 'big business' to solve the social ills of the world through generous actions of corporate social responsibility would blunt the democratic skills of the community and its relationship with government.[183] All of these issues bring the spotlight back to the ethical and moral considerations made by the decision-makers within corporations as to how they interact within the community, how they treat their employees, how they treat their customers and potential customers and the vital relationships they

[180] Ibid, 897.
[181] Moriarty, above n 128.
[182] For example Margolis, J.D. & J.P. Walsh, "Misery Loves Companies: Rethinking Social Initiatives by Business" (2003) 48(2) *Administrative Science Quarterly* 268– 305, Orlitzky, M., F.L. Schmidt, & S.L. Rynes, "Corporate Social and Financial Performance: A Meta-Analysis" (2003) 24(3) *Organization Studies* 403– 441, Vogel, D., *The Market for Virtue: The Potential and Limits of Corporate Social Responsibility* (Brookings Institution Press, 2005).
[183] Moriarty, above n 128.

have with suppliers. These moral and ethical considerations ultimately have a direct effect on the viability of the company and the potential harm caused to consumers.

As Sarre[184] points out, there have been many corporate collapses that have caused harm to the community in one form or another. He would suggest that the fall from grace of entities in Australia such as HIH (insurance), OneTel (communications), Ansett (transport) and Harris Scarfe (retail) were all related to greed. Subsequent to those collapses there were two opposing views to the then current state of affairs. Sarre notes that legal writer and former chairman of the ACCC Bob Baxt claimed that there were sufficient laws and regulations but the regulators needed to enforce the laws. Stan Wallis, who was the chairman of the Wallis Inquiry into the financial services sector, claimed that there were too many laws and regulations that were stifling good decision making in corporations.[185] Sarre concludes:

> The traditional managerial responsibility to fulfil society's demand for accountability and to mitigate financial risk is usually seen simply at the level of legal responsibility, that is, obeying the law and meeting minimum standards. The problem is that the law is slow and expensive, and acts ex post facto. Minimum standards quickly become maximum standards. Recent history has reinforced the notion that, in order to prevent corporate disaster and corporate irresponsibility, the state cannot simply rely upon legal regulation, nor simply leave matters to the market. Companies, with the positive encouragement of governments, must develop initiatives to cultivate an organisational 'culture of mindfulness', including an awareness of the possibility of illegality, a personal ethic of care, and an assumption of responsibility in the event that improper practices occur, in short, an ethic referred to broadly as corporate social responsibility.

It is clear that the ethical standards of the 1980s are not those of the 2000s and even less of this current decade. It is important that the ethical standards demanded by the public are reinforced in corporations. As Sarre states,[186] legislation is slow to react, and therefore the public must insist that the ethics

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184 Sarre, Rick, "Responding to Corporate Collapses: Is There a Role for Corporate Social Responsibility?" (2002) 7(1) *Deakin Law Review* 1.
185 Ibid.
186 Ibid.

and morals of the current generation (at any point in time) are respected by the corporations of the day. As the population grows there will be more consumers who will demand that respect. As legislation is slow to react to manage the activities of corporations, it is therefore essential to put in place a mechanism that will protect consumers with active entitlements regardless of the slow reactions of government.

2.7 Chapter summary

The elements of this chapter will guide the ultimate resolutions and answers to the questions posed in this thesis. There are numerous theories about why regulation occurs, what motivates those responsible for regulation to do what they do, and the multitude of instruments and methods by which regulation may be employed.

Developing regulation to resolve an issue requires that issue to be constructed in such a manner that the solution developed will resolve the actual issue.[187] Given that the proposed solution(s) will require regulatory measures and those responsible to instruct or legislate will be the politicians of the day, it is also necessary to frame the issue in such a manner that it will not only attract political interest but inspire them to delve into the issue and action regulatory measures. Whilst those regulatory measures do take time to develop and implement, the discussion here about Corporate Social Responsibility has been considered as an affordable and sustainable overlap, which could be implemented with tangible benefits for both the company and the consumer.[188]

Finally, as a reminder of the reason for this thesis, consumer detriment is caused every time a failing company leaves the consumer with active entitlements. Unlike other unsecured creditors, consumers are not able to negotiate a position that alleviates any risk dealing with a company. The

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[187] Vicky Comino, 'Towards better corporate regulation in Australia' (2011) 26 *Australian Journal of Corporate Law* 6.

[188] Dirk Matten and Jeremy Moon, '"Implicit" and "Explicit" CSR: A Conceptual Framework for a Comparative Understanding of Corporate Social Responsibility' (2008) 33 *Academy of Management Review* 1.

theories discussed have framed the reasoning around why detriment, or financial harm, caused to anyone in society should be mitigated.

The following chapter will review regulatory policy, systems and the network of committees that mesh together to protect consumers in Australia, as well as the USA and the EU. Furthermore, the regulation that guides the process when a company fails must be examined to understand how the consumer is treated under that legislation. It will become evident that there is a gap in regulation to protect or compensate the consumer with active entitlements.

THREE

HISTORY & CONTEXT – CURRENT REGULATION

3.1 Introduction

A consumer is protected by, and subject to, an array of regulatory instruments, which offer varying measures of protection whilst the supplier of goods and services continues to trade, and also when they cease to trade.[1] Laws and regulations that are classified as 'Consumer Protection' have developed slowly, mainly out of contract law, and over many years into command-and-control legislative instruments, not only in Australia, but also around the world.[2] Like many emerging legal areas, consumer protection laws have been created in response to a situation with policy development following slowly behind. The regulations that support business creditors at a time when a company fails have also developed as commercial activities increased over time.[3] Insolvency law provides various protections for different classes of creditor but has never been specifically protective of a consumer with active entitlements. The consumer, as a reluctant creditor, is grouped as an unsecured creditor.[4] This chapter reviews the policies and legislation that define Consumer Protection and Insolvency today as well as tracing their historical development. This review will assist to establish the predicament of the consumer holding active entitlements when a company ceases to trade, which is the focus of this thesis.

In discussing the legislation in place in Australia, United States of America and the European Union, and to allow a clear comparative analysis, a brief overview of the legal systems established in each country and area will also be described.

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[1] For example *Sale of Goods Act 1896* (Qld), *Competition and Consumer Act 2010* (Cth), *Fair Trading Act 1989* (Qld).

[2] Stephen P King and Rhonda L Smith, 'The shaky economic foundations of consumer protection policy and law' (2010) 18 *CCLJ* 71.

[3] *Corporations Act 2001* (Cth) Chapter 5..

[4] Lynn M LoPucki, The Unsecured Creditor's Bargain (1994) 80(8) *Virginia Law Review* 1887, 1896.

3.1.1 Australia – legal system

With the settlement of Australia by the British in the 1700s came the introduction of the British legal system as well as its legislative framework. The laws applicable at that time were restricted to those laws necessary for the new situation and a new colony[5]. This limitation proved frustrating initially as the colony was no more than a penal colony under military rule. It should be noted here for completeness that the legal system established in Britain at that time consisted of a well-established portfolio of statute law, common law and equity, all of which were ultimately transplanted into Australia on 25 July 1828 by an act of British parliament[6]. The reception date of those laws by the different states in Australia varied depending on when each state was established.[7]

As the individual states continued to develop and expand, there began to be a collective concern over matters such as defence, immigration, foreign trade and transport. In 1881 a conference was held in Sydney to discuss the issue of customs duties. Whilst there were differing attitudes from state representatives, it was the first time that the idea of a national or federal council was considered.

Having realised the inadequacies of the Federal Council, in 1891 Sir Henry Parkes called for the creation of a federal government and a federal parliament and, as its president, convened the National Australian Convention with delegates from each colony. A draft constitution was finally presented to each state parliament but the idea of the Federation was all but lost as each colony was more focused on combating an economic depression in the 1890s.[8]

In the 1890s, the Australian Natives Association (ANA) continued to take up the mission of federation and in 1893 proposed a second Constitutional

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[5] Gwen Morris et al, *Laying Down the Law* (Butterworths, 4th ed, 1996), 27.

[6] *Australian Courts Act* (9 Geo IV, c 83).

[7] The boundaries of New South Wales at the time included what is now known as Queensland and Victoria and therefore the date of reception in those three states was 25 July 1828. That date also applied to Van Diemen's Land, now Tasmania. Western Australia was founded on 1 June 1829, South Australia on 28 December 1836, Australian Capital Territory and Northern territory were both proclaimed on 1 January 1911.

[8] Skwirk, <http://www.skwirk.com.au/p-c_s-14_u-127_t-349_c-1209/steps-to-federation-1883-1901/nsw/history/australia-to-1914/federation-and-australia-s-constitution>.

Convention, which would include delegates elected by the people from their colony. Over several years the convention, held as a series of meetings, moved from Adelaide to Sydney and then Melbourne and was led by Sir Edmund Barton after Parkes had died the previous year. As originally proposed by the ANA, the people would have to vote for the Constitution Bill. After a failed first referendum, and some amendments after a secret 'Premiers' conference', the second referendum was passed with a strong 'yes' vote. The *Commonwealth of Australia Constitution Act* 1900 (UK) was passed on 5 July and on 9 July received full royal assent. Queen Victoria royally proclaimed Australia on 17 September and declared that the *Commonwealth of Australia Constitution Act* 1900 (UK) would take effect on 1 January 1901.[9]

The *Australian Constitution*, as voted by the people, provided for the Commonwealth to have specific powers such as customs[10], military forces[11], currency[12] and free trade between the states.[13] Additionally, there were concurrent or shared powers[14], and residual powers exclusively for the states.[15] In terms of legal systems and layers, two layers were established within Australia, Commonwealth and State, and a third being the Privy Council in England, which was held as the highest court for Australia for many years. Through the passing of a number of Acts[16] over almost 20 years the legal connection between England and Australia was severed[17] and the High Court is now the highest court in Australia.

With the later addition of local councils (created by state governments), there are now three levels of government within Australia. One must consider then, for any situation, whether there is a state law, federal law, or both that may affect the situation. It should be noted that where both exist, and there may be an inconsistency between the state law and the federal law, s109 *Australian*

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[9] Ibid.
[10] *Australian Constitution* s90.
[11] *Australian Constitution* s114.
[12] *Australian Constitution* s115.
[13] *Australian Constitution* s92.
[14] *Australian Constitution* s51.
[15] Andy Gibson and Doug Fraser, *Business Law* (Pearson, 9th ed, 2016), 29.
[16] *Privy Council (Limitation of Appeals) Act 1968* (Cth), *Privy Council (Appeals from the High Court)A Act 1975* (Cth), *Australia (Request and Consent) Act 1985* (Cth) , and *Australia Act 1986* (Cth).
[17] Gibson and Fraser, above n 11, 30.

Constitution provides that, to the extent of the inconsistency, the state law shall be invalid.[18]

3.1.2 Australia - Consumer Protection Policy & Law

The elements of consumer protection in Australia began well before the British settled in Australia. Certainly in the early centuries of life in England there would not have been any concern for purchasers of goods. Most people prior to the 18th century provided their own goods and services, possibly bartered where necessary, and they purchased little. Purchasing required money and, as no one had jobs as we know them today, consumers did not really exist. If there were specialists in making particular items, such as candles for instance, bartering would have been the most common method of trade and, as villages were small, if the candlestick maker provided a bad product, word of mouth would make him change his product or go out of business. The general rule of sales was *caveat emptor*, or buyer beware.[19]

In England the 18th century brought the Industrial Revolution, which created many jobs in larger towns and cities and reduced the need for all people to work as farmers. Having a job provided money, and as the worker had no time to produce goods, they purchased instead. The Industrial Revolution was the beginning of mass production of products and with that a larger number of manufacturers, introducing competition to the market place. The level of manufacturing and competition in local country market places has increased dramatically in the last two centuries. Furthermore, in the last few decades, the market place has now become a global market place through the rapid development of telecommunications, digital technology and specifically, the Internet.

In any market place, firms want to produce their products at the lowest possible price and sell them at the highest possible price. At the same time, the buyer will want to choose from a number of similar products and buy the

[18] Ibid 35.

[19] Commonwealth, *Parliamentary Debates*, The Senate, 30 July 1974, 1-9 (The President of the Senate).

product at the lowest possible price.[20] As the market place identifies the buying patterns of the consumer, "the firm will respond through product innovation, improved service and better allocation of resources as they compete with each other for the customer."[21] It can be seen therefore, that market places are consumer-driven. Consumer purchasing patterns are the signals to firms as to what goods, quality of those goods, and purchase price the consumer is willing to pay.

Economists build models to compare 'reality' and thereby understand where market places can improve. The baseline model is of Perfect Competition and "occurs in a market where:

- There are many firms, each selling an identical product.
- There are many buyers.
- There are no restrictions on entry into the industry.
- Firms already in the industry have no advantage over potential new entrants.
- Firms and buyers are completely informed about the prices of the products of each firm in the industry."[22]

In reality, firms can collude to fix prices on certain products, thus reducing competition and consumer choice, potentially to the detriment of the consumer. [23] Alternatively, firms can affect consumer choice through misleading or deceptive conduct by a number of means including false advertising,[24] which could lead to reduced competition within the marketplace. Along with the model of perfect competition, which in reality is imperfect, the neoclassical economist will assume that consumers are 'rational' "in that they possess all relevant information necessary to make a prudent and rational

[20] Alex Bruce, *Consumer Protection Law in Australia* (Butterworths, 2nd ed, 2014), 9.
[21] Ibid.
[22] Douglas McTaggart, Christopher Findlay and Michael Parkin, *Economics* (Addison-Wesley Publishing, 1992), 257.
[23] For example see *ACCC v High Adventure Pty Ltd* (2006) ATPR 42-091.
[24] See *Colgate Palmolive Pty Ltd v Rexona Pty Ltd* (1981) 37 ALR 391.

decision about whether to enter into the transaction in question".[25] Of course consumers are human, with all of the human frailties, biases and behavioural issues attached.

Bringing the larger, wiser, well-oiled machinery of corporations together with the far-less knowledgeable human consumer to the table to make 'freely negotiated' contracts for the sale of goods, should, in the perfect marketplace, be a fair fight. In the 21st century however, there is usually a large difference in bargaining power between the two parties and corporations have come to offer 'standard contracts' with a 'take it or leave it' approach to negotiation.[26]

Ultimately, "significant differences in bargaining power which undermines the consumers' ability to protect their interests, the lack of information available to consumers, and the consumers' inherent and very human biases and flaws means that markets can therefore never function with the sort of theoretical efficiency necessary to deliver consumer welfare".[27]

This is where governments can step in and support the consumer with policies and legislation directed at both *competition* and *consumer protection*.

3.1.2.1 Australia - Consumer Protection Policy

Consumer policy in Australia is a shared responsibility of the federal government and the state governments. The Commonwealth Department of Treasury provides advice to the Commonwealth Government whilst the various departments of Fair Trading in each state advise the relevant state government.[28] The development of the policy framework for consumer law is a joint effort of the various state ministers who meet at the COAG Legislative and Governance Forum on Consumer Affairs Forum (CAF).

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[25] Bruce, above n 16, 12.

[26] Ibid.

[27] Ibid 13; To further justify the claim regarding 'imbalance of bargaining power', the ABS stated that as at 30 September 2020 the population was 25,693,059, and of those there were 3,185,938 aged under 9. The remainder of 22,507,121 could be fairly classed as consumers. The Australian Small Business and Family Enterprise Ombudsman claimed that as at February 2019 there were a total of 2,313,291 businesses operating. There were a significant number of individual consumers potentially dealing with business, and at a disadvantage, compared with business-to-business dealings.

[28] The Treasury, Australian Consumer Law <http://consumerlaw.gov.au/consumer-policy-in-australia/development/>.

CAF works jointly with Consumer Affairs Australia and New Zealand (CAANZ) with its policy objective being:[29]

> To improve consumer well-being through consumer empowerment and protection, fostering effective competition and enabling the confident participation of consumers in markets in which both consumers and suppliers trade fairly.

Furthermore, there are six supporting objectives:[30]

1. to ensure that consumers are sufficiently well-informed to benefit from and stimulate effective competition;
2. to ensure that goods and services are safe and fit for the purposes for which they were sold;
3. to prevent practices that are unfair;
4. to meet the needs of those consumers who are most vulnerable or are at the greatest disadvantage;
5. to provide accessible and timely redress where consumer detriment has occurred; and
6. to promote proportionate, risk-based enforcement.

Clearly these objectives reflect the issues discussed above about the imperfect marketplace and the problems that the consumer faces as well as the potential contention between suppliers.

The strategic agenda for CAF contains a number of 'aspirations' or goals for 2015-17 including one where:[31]

> *Consumers are making informed decisions and receive redress when things go wrong, wherever they are and however they buy*
>
> • Consumers take responsibility for the risks they can control
>
> • Vulnerable consumers are protected
>
> • The consumer protection framework enables consumers to confidently participate in the market.

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[29] Legislative and Governance Forum on Consumer Affairs Consumer Affairs Australia New Zealand, 'Charter 2015-17' (12 November 2015) <http://consumerlaw.gov.au/files/2016/04/CAF_Charter_2015-17.pdf>.

[30] Ibid.

[31] Legislative and Governance Forum on Consumer Affairs Consumer Affairs Australia New Zealand, 'Strategic Agenda 2015-2017' (June 2015) <http://consumerlaw.gov.au/files/2015/09/CAF_strategic_agenda_2015.pdf>.

It is relevant to now visit the policy framework under which this Council acts and decides why and when the consumer should be protected. “Australia and New Zealand are both members of the OECD Committee on Consumer Policy and contributed to the development of the 2010 OECD Consumer Policy toolkit”.[32] The document, Consumer Policy in Australia[33] is known as a companion to the OECD Consumer Policy Toolkit and describes in detail Australia’s Consumer Policy Framework. The OECD Policy Toolkit[34] states that “one of the principal functions of governments of market-based economies is to establish and maintain economic frameworks that promote innovation, productivity and growth” and “consumer policy is a means of achieving this through setting up regulatory frameworks to protect and inform consumers and prevent anti-competitive practices”.[35]

The companion document discusses the many and varied influences upon the general policy framework and also more specifically, the influences within Australia. These influences include:

- economics: the way consumers interact with and in markets,
- the changing market landscape such as a greater variety of goods and services, the influence of technological change, and the consumers’ increasing expectation of higher quality goods and services.
- political, social, legal and moral issues that arise over time.

There is a six-step approach to consumer policy issues:[36]

Step 1: Define the consumer problem and its source.

Step 2: Measure consumer detriment.

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[32] The Treasury, Consumer, <http://www.treasury.gov.au/Policy-Topics/Consumer>.

[33] Policy and Research Advisory Committee of the Standing Committee of Officials of Consumer Affairs, 'Consumer policy in Australia: A companion to the OECD Consumer Policy Toolkit' (March 2011) <https://consumerlaw.gov.au/sites/consumer/files/2015/09/Companion_to_OECD_Toolkit.pdf >..

[34] OECD, 'Consumer Policy Toolkit' (9 July 2010) <http://www.oecd.org/sti/consumer/consumer-policy-toolkit-9789264079663-en.htm>.

[35] Policy and Research Advisory Committee of the Standing Committee of Officials of Consumer Affairs, above n 32, 3.

[36] Ibid, 8.

Step 3: Determine whether consumer detriment warrants consumer policy action.

Step 4: Set policy objective and identify the range of policy actions.

Step 5: Evaluate options and select a policy action.

Step 6: Develop a policy review process to evaluate the effectiveness of the policy.

The first step is to clearly define whether the issue or complaint is actually related to a consumer or something else, such as competition. The issue may relate to current regulations and therefore be handed on to an appropriate regulator, such as the ASIC if it were to do with financial services, the Department of Health if it were to do with food labelling, and so on.

The second step, once a consumer issue has been isolated, is to measure the consumer detriment. The OECD Consumer Policy Toolkit summarises:[37]

> Consumer detriment arises when market outcomes fall short of their potential, resulting in welfare losses for consumers. Identifying and measuring the nature and magnitude of consumer detriment (how consumers are being harmed and the number of, and extent to which, consumers are being harmed) is a crucial component of evidence-based policy making.
>
> Elements of detriment include both financial and non-financial impacts, such as direct financial losses, time loss, stress and physical injury. Although quantification is oftentimes difficult, it is essential that detriment be assessed, even when it is only possible to do so in a qualitative manner. Possible sources of information for assessments include focus groups, complaints data, consumer surveys, market screening and econometric analysis.
>
> A good appreciation of consumer detriment provides a policy maker with the evidence to build a case, if warranted, for a market intervention (Step 3), and is also helpful in establishing an effective policy objective (Step 4).

The basic premise of this thesis is that when a consumer enters into a contract to buy a product, with the comfort of the guarantees provided by the Australian Consumer Law as well as any other explicit warranties provided by the supplier, the consumer should not incur any detriment within the timeframe provided by the contract and those guarantees and warranties.

[37] OECD, above n 30.

When a supplier enters into liquidation, or any other form of insolvency administration, during that timeframe, a consumer can incur detriment.

There are a number of factors that are considered when measuring consumer detriment:[38]

1. *Tangible economic detriment* measures inconvenience, time, and monetary costs. This could include the cost of repairing and replacing an item, and following up and resolving problems, including the costs of travel, postage and telephone calls, as well as personal time.
2. *Intangible costs* are largely focused on emotional detriment, and are not normally measured. Emotional detriment attempts to place a value on the frustration, stress, annoyance, disappointment and lack of choice experienced by consumers. Ultimately, it can have very high costs in terms of 'peace of mind' or health effects, if the issue is significant and insidious.

If, for example, a consumer purchased a relatively expensive Dick Smith branded plasma television from Dick Smith Electronics (DSE)[39] prior to its closing down and entering into liquidation, and the set failed for some reason within twelve to eighteen months after the purchase and after liquidation, the consumer would be faced with both tangible and intangible costs. The consumer would have to pay the same amount to purchase a similar product as well as incur more costs in travel and personal time. Furthermore, they would incur the emotional stresses described above, which the Productivity Commission[40] suggests is an additional 25% of the tangible economic cost.[41]

The next step in the process is to consider whether the consumer detriment warrants any policy action. The first element is to determine the scale of the consumer detriment. "An intervention may be warranted if the detriment is

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[38] Policy and Research Advisory Committee of the Standing Committee of Officials of Consumer Affairs, above n 29, 20.

[39] Dick Smith Holdings Ltd (ASX:DSH) (Dick Smith) was a large electrical goods retailer, operating approximately 390 stores across Australia and New Zealand. On 5 January 2016, the Australian Securities Exchange suspended Dick Smith's securities from quotation. <http://asic.gov.au/about-asic/media-centre/key-matters/dick-smith-holdings-limited/>.

[40] Productivity Commission, *Review of Australia's Consumer Policy Framework*, Report No 45, Canberra, 2008, Chapter 14.

[41] Policy and Research Advisory Committee of the Standing Committee of Officials of Consumer Affairs, above n 29, 21.

small, but felt by a large number of consumers, or alternatively, if the detriment experienced even by a small group of consumers is very large."[42]

It is suggested here that further information is required to clearly answer that question with regards to the scale of how many companies enter into administration and, more importantly, how many customers they have. It has been shown that an average of 9800 companies have entered into external administration annually over the last five years.[43] The number of customers for each of those companies is unavailable, however, another source of information will shed some light on the issue of detriment within the community.

Since the implementation of the ACL, the Australian Consumer Survey was introduced to analyse the impact of the new laws in Australia. "The 2016 survey provides insights into consumer and business experience and understanding of consumer laws, their application and enforcement following the commencement of the ACL on 1 January 2011."[44] Whilst the survey's main intention was to understand how both consumers and business have viewed the new consumer laws, there was also a measure of consumer problems during the year surveyed. The 2016 survey[45] makes comparisons to a similar survey conducted in 2011 with some key findings summarised below.

- Six in ten (59%) consumer respondents had experienced at least one problem related to a product or service in the last two years, down from 74% in 2011.
- The most common types of problems experienced were related to faulty, unsafe or poor quality products (30% compared to 27% in 2011), poor customer service (26% compared to 37% in 2011) and the provision of incorrect or misleading information (24% in 2015 and 2011).

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[42] Ibid 23.

[43] ASIC, 'Australian Insolvency Statistics' (August 2016) <http://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-1-companies-entering-external-administration/>.

[44] Australian Consumer Law, <http://consumerlaw.gov.au/australian-consumer-survey/>.

[45] Ernst & Young, 'Australian Consumer Survey 2016' (18 May 2016).

- Industry sectors where consumer problems were more likely to arise were:
    - Telecommunication products or services – 26% of consumers who made a purchase in this category experienced a problem (compared to 31% in 2011)
    - Internet service providers – 25% of consumers who made a purchase in this category experienced a problem (compared to 32% in 2011)
    - Electronics/electrical goods – 19% of consumers who made a purchase in this category experienced a problem (26% in 2011)
- Consumers showed a higher propensity to take action to resolve their problems compared to the 2011 survey – 82% of consumers who experienced a problem took action to resolve it, compared to 75% in 2011.

Alarmingly, "it is estimated that it costs consumers $16.31 billion each year to deal with problems, a decrease from 2011 ($16.36 billion). Whilst the number of consumer problems has decreased significantly, the overall cost of consumer problems is only marginally lower. This is due to a higher proportion of consumers now taking action to resolve their problems and an increase in direct costs incurred by consumers when addressing their problem (average annual spend per person in 2015 was $299 compared to $221 in 2011)."[46]

The Consumer Survey does not specifically cover issues that consumers may encounter with companies entering liquidation; however, the statistics from this survey would suggest that even a small proportion of $16.31 billion is still a considerable consumer detriment, further justifying the need to provide some regulatory protection for consumers when a company ceases to trade.

It is appropriate at this stage to begin to follow the six-step approach to consumer policy issues as stated earlier. The first step was to define the issue. This thesis has defined that issue: Protecting consumers holding active entitlements when a company ceases to trade. The second step was to measure the detriment. Although not quantified specifically, it has just been shown that a considerable amount of detriment is likely to occur to consumers

[46] Ibid.

where a company has ceased to trade, based on the two consumer surveys. Step three was to determine if consumer detriment warrants consumer policy action, and arguably that was considered positive in Chapter 2.

3.1.2.2 Australia - Consumer Protection Law

What are the guarantees offered by the ACL? As described in chapter one, consumer protection laws used to be fragmented across various legislations such as the Sale of Goods Acts and Fair Trading Acts in states and territories and also the TPA[47] under Commonwealth legislation. In 2006 the Productivity Commission, an agency of the Australian Government within the Treasury portfolio, conducted an inquiry into then current consumer protection policy, examining ways in which it could be improved. The final report[48] made a number of recommendations including that a new national consumer law be implemented across all jurisdictions, based on the consumer protection provisions of the TPA. In October 2008 COAG agreed to implement the new policy regime, which would include the best practice from each states' consumer legislation. As part of the implementation to make the new law apply consistently across all jurisdictions the states were required to include the new law as an 'applied law'[49] in each of their own (Fair Trading) laws due to some limitations of power, stemming from the Constitution, for the Commonwealth Government. Overcoming this technicality then allowed the states to pass much of the enforcement to the ACCC. At the Commonwealth level, the ACL exists as text in Schedule 2 of the *Competition and Consumer Act 2010* (Cth).

Each of the guarantees applies to the 'consumer', but what is a consumer? In its simplest form, s3 ACL defines the consumer, in relation to purchasing goods or services, as a person who has purchased goods or services that did not exceed $40,000 in value or, the goods or services were of a kind usually acquired for personal, household or domestic use. It should be noted that the

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[47] For a complete understanding of the consumer protection laws within the TPA see Lynden Griggs, Eileen Webb and A.Y.M. Freilich, *Consumer Protection Law* (Oxford University Press, 1st ed, 2008).

[48] Productivity Commission, above n 36.

[49] Bruce, above n 16, 19.

'person' in that statement could be a company. If the 'person' purchasing those goods re-supplies them, uses them in a manufacturing process or uses them in a repair process, that person would not be classed as a consumer under s3 ACL, and the guarantees would not apply.

A recent Australian Consumer Law Review report [50] contains many recommendations to update the ACL with Proposal 15 being to "increase the $40,000 threshold in the definition of 'consumer' to $100,000".[51] There are two main reasons for this change; firstly, the $40,000 has not changed since 1986 and an increase will take inflation into account; and secondly, the increase will assist small businesses as they are generally "as time poor as ordinary consumers and lack knowledge and expertise about products they buy".[52] For the purposes of this thesis, if that change were to be implemented, the threshold increase would significantly increase the size of the class of persons potentially affected by a suppliers' liquidation.

The guarantee that goods or services will be of acceptable quality is stated in s54 ACL. Bruce[53] comments that the TPA version of this guarantee was labelled as 'merchantable quality' the meaning of which attracted significant legal debate. The change of label along with a number of subsections in s54 ACL are intended to make the intentions of the legislation clear. For this section to apply, the goods must be supplied to a consumer, by a person, in trade or commerce, effectively ruling out any 'private sale'. The goods cannot be sold at an auction.

For clarity, sub-sections 2 and 3 state:[54]

> (2) Goods are of acceptable quality if they are as:
>
> (a) fit for all the purposes for which goods of that kind are commonly supplied; and
>
> (b) acceptable in appearance and finish; and

[50] Consumer Affairs Australia and New Zealand, 'Australian Consumer Law Review - Final report' (March 2017).

[51] Australian Consumer Law, *Changes to the Australian Consumer Law* (8 April 2021) Australian Consumer Law https://consumerlaw.gov.au/index.php/resources-and-guides/changes-to-acl: announcement that the increase to $100,000 will occur as of 1 July 2021.

[52] Ibid 73.

[53] Bruce, above n 16, 245.

[54] Australian Consumer Law s54(2).

(c) free from defects; and

(d) safe; and

(e) durable;

as a reasonable consumer fully acquainted with the state and condition of the goods (including any hidden defects of the goods), would regard as acceptable having regard to the matters in subsection (3).

(3) The matters for the purposes of subsection (2) are:

(a) the nature of the goods; and

(b) the price of the goods (if relevant); and

(c) any statements made about the goods on any packaging or label on the goods; and

(d) any representation made about the goods by the supplier or manufacturer of the goods; and

(e) any other relevant circumstances relating to the supply of the goods.

These subsections are relevant in the discussion at 3.1.2.3 about the timeframe in which a consumer can rely on this guarantee.

When a consumer states the purpose for which they wish to purchase and use a product or service, and the supplier offers that the goods will be fit for that purpose, s55 ACL will guarantee that 'fitness for purpose'. This guarantee places onus on the supplier to provide goods that are fit for the purpose as stated by the consumer, e.g. walking shoes. In this instance the consumer relies upon the supplier who will have greater knowledge of the product and its fitness for the stated purpose.[55]

Section 56 ACL protects a consumer if they purchase goods based on a description supplied by the supplier, generally in catalogues or advertisements. The goods that are supplied must match that description, which can include details such as colour or size or material, depending on the circumstances.[56] In a similar manner, s57 ACL relates to goods supplied by sample or demonstration model. The goods supplied must be the same as the

[55] Bruce, above n 16, 252.

[56] Adrian Coorey, *Australian Consumer Law* (Butterworths, 1st ed, 2015), 547.

sample or demonstration model and the consumer must be given time and opportunity to compare samples and the delivered goods.[57]

In making a choice between products and/or suppliers of the same product, a consumer may well be concerned about the availability of spare parts and a repair service. The guarantee as to repairs and spare parts is detailed in s58 ACL. Subsection (1) includes that:

> there is a guarantee that the manufacturer of the goods will take reasonable action to ensure that facilities for the repair of the goods, and parts for the goods, are reasonably available for a reasonable period after the goods are supplied.

The word 'reasonable' is used several times in that passage and will be addressed in the time frame discussion at 3.1.2.3.

A further guarantee, and a very relevant one, is the guarantee related to express warranties in s59 ACL. Suppliers use the provision of an express warranty, over and above those provided by these ACL guarantees, as a marketing tool to entice consumers to purchase their product over another.[58] This ACL guarantee ensures that suppliers will comply with those express warranties.

Having these guarantees in place provides the consumer with a level of comfort should something detailed in these guarantees occur. Should a consumer have an issue, they can 'reject' the goods and this is provided for under s259 ACL. Rejecting the goods means to initially contact the supplier.

3.1.2.3 What happens when the supplier is no longer trading?

According to s262 ACL there are limits on the consumers' right to reject goods and s262 (1)(a) ACL states that one limitation is when "the *rejection period* for the goods has ended".

At s262 (2) ACL:

> The *rejection period* for goods is the period from the time of the supply of the

[57] Ibid.

[58] Devavrat Purohit and Joydeep Srivastava, 'Effect of Manufacturer Reputation, Retailer Reputation, and Product Warranty on Consumer Judgments of Product Quality: A Cue Diagnosticity Framework' (2008) 10 *Journal of Consumer Psychology* 123.

goods to the consumer within which it would be reasonable to expect the relevant failure to comply with a guarantee referred to in section 259(1)(b) to become apparent having regard to:

(a) the type of goods; and

(b) the use to which a consumer is likely to put them; and

(c) the length of time for which it is reasonable for them to be used; and

(d) the amount of use to which it is reasonable for them to be put before such a failure becomes apparent.

To be clear, s259 (1)(b) ACL states:

> a guarantee that applies to the supply under Subdivision A of Division 1 of Part 3-2 (other than sections 58 and 59(1)) is not complied with.

Subdivision A of Division 1 of Part 3-2 includes sections 51-59, the guarantees described above. As a minimum, the guarantee expressed in s59(2) ACL to "guarantee that the supplier will comply with any express warranty given or made by the supplier in relation to the goods" is significant. Most supplier warrantees for the majority of consumer household goods are a minimum of one year, with many varied periods offered by different suppliers for different goods.[59] Given these time periods, with a minimum of one year and up to twenty-five years, there is a significant opportunity for the supplier to cease to trade, either voluntarily or instigated by a creditor, under the liquidation process as described in 3.6.3.

It is now relevant to consider the circumstances in the other jurisdictions to determine if consumers with active entitlements are legally protected in those jurisdictions.

3.2 United States of America – legal system

[59] Examples: 2 year Manufacturer's Warranty with all Haier appliances - <https://www.haier.com.au/warranty/>; Westinghouse Dishwashers 2 years, Ovens 2 years, Microwave 1 year, Fridge & Freezer 2 years - <https://www.westinghouse.com.au/warranties/>; Coco Republic – Structural Warranty for furniture 5 years, Structural Warranty for Outdoor furniture 2 years, Structural Warranty for Lighting and Home wares 1 year - <https://www.cocorepublic.com.au/cms-warranty/>; Hyundai Cars 5 year unlimited kilometres - < https://www.hyundai.com.au/ownership/unlimited-km-warranty>; Origin Energy Solar Panels - 10-Year manufacturer warranty and 25-year linear power production warranty - <https://www.originenergy.com.au/for-home/solar/systems-batteries.html#premiumplusrange>.

The USA or America has a somewhat similar history to Australia in its legal and governmental development. The first English settlement was in 1607.

Whilst the majority of early settlers in Australia were from the greater United Kingdom (English, Scottish, Irish and Welsh), settlers in early America, mainly due to proximity, came from not only United Kingdom but also European countries such as Spain, Germany, Sweden and Switzerland. Along with those settlers also came diversity in religion.[60] Most importantly, there was diversity in the political organisation of the colonies. The British controlled a number of provinces as they did in Australia, with a governor providing local direction and laws being made remotely in England. Other provinces were given a royal grant and a proprietor or group of proprietors would govern the province, and yet others were corporate colonies under royal control. This mix of control of provinces over time caused many conflicts and ultimately culminated in the American Revolution. In 1774 a delegation of members of the colonies attempted to persuade the Crown to release the colonies from Crown rule, but that was rejected and fighting continued. There were attempts to sever ties with England, which finally succeeded in 1776. This action did not, however, unite the colonies.[61] As happened in Australia, conventions were held with members from each of the colonies to construct what might become a Constitution for a united group of provinces. The Constitution of America was finally accepted and signed in 1788 and the first president was George Washington. In similar fashion to the Australian Constitution, the federal government of America had limited powers and the remainder of powers were delegated to the states. America therefore has at least a dual level parliamentary system and legal system.

In terms of the legal system, there were initially 13 separate states and 13 different legal systems and as other states were included from other sovereignties that number grew, and their legal systems were even more disparate. The basis for most of them, however, was the English legal system.[62] In the 1600s there was a shortage of trained lawyers in America, which encouraged the local lawmakers to codify laws to local conditions rather

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[60] E Allan Farnsworth, *An Introduction to the Legal System of the United States* (Oxford University Press, 4th ed, 2010), 4.
[61] Ibid 5.
[62] Ibid 9.

than refer to case law or indeed English laws. As the population grew in the 18th century, more trained lawyers either relocated from England or other scholars went to England to study and the review of colonial laws in England had become more thorough and so the legal system resembled the English system more. When the Revolution came and the English control was removed there was a move to not use case law and even recode laws. Laws were developed to local requirements in each state, often to customs of farmers or gold miners. Ultimately, all state and federal legal systems now utilise a case law system with precedents, each with a strong volume of statute law.[63] There is a hierarchy of statute law being, from the highest level, the Constitution, Treaties, Federal statutes, Federal executive orders (from the President), State constitutions and then state statute.[64]

3.2.1 USA - Consumer Protection Policy & Law

The early history of consumer protection in the USA follows much the same line as described above for Australia due to the influence of the British in its early development. The dramatic surge in production of packaged goods and pre-prepared produce, as the Industrial Revolution took hold in the USA, was the initial source of consumer complaints. Those complaints also caused some angst in the legal system. In general, consumer complaints prior to the Industrial Revolution were handled as a breach of contract case.[65] The increase of manufacturers, and therefore on-sellers or retailers to the general consumer, meant that contract law could no longer be the basis of a complaint due to the doctrine of privity. The judiciary had to find new ways of handling these disputes and

> This reworking of traditional doctrine was not the result of conscious judicial policymaking. Rather, it reflected the inadequacy of existing doctrine to resolve buyer-seller disputes in an unfamiliar setting. Efforts to adapt then prevailing notions of tort and contract doctrine to changed economic

[63] Ibid 54.
[64] Ibid 70.
[65] Timothy J Sullivan, 'Innovation in the Law of Warranty: The Burden of Reform' (1980) 22 *Hastings Law Journal* 341, 359.

> conditions ultimately dealt a fatal blow to privity as a means of restricting a remote seller's liability and produced the modern law of 'products liability'.[66]

There were a series of cases involving food and food poisoning that dispensed with the privity doctrine, but the case of Davis[67] introduced the term 'implied warranty' (of merchantable quality) and exposed the changes in economic conditions such that once upon a time a person went to the market to buy food and was able to inspect it before purchase. The new era of manufacturing did not give the purchaser, generally, the option to inspect before purchase. Within a short period other cases came to the fore as other plaintiffs argued that the relaxation of the privity rule could be applied to non-food situations.[68] Moreover, those decisions in favour of the complainant occurred only where there was physical harm sustained. In situations where there was economic harm, the supplier seemed to benefit from the courts.[69] This stance was also supported by the introduction of the Uniform Commercial Code (UCC) in 1952, which provided "the seller certain means to minimise liability for economic loss".[70] The UCC was developed by the Uniform Law Commission[71] with the goal of harmonising laws in the areas of sales and commercial transactions. The increase of transactions across borders with the USA needed some regulation and the UCC was then adopted by the state legislatures.

Earlier that century President Franklin Roosevelt introduced at the federal level, a new mechanism for consumer protection: The United States Federal Trade Commission (FTC). The FTC, created in 1914, had two main goals: to protect consumers and to maintain competition. The FTC Act[72] is essentially

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[66] Ibid 360.
[67] *Davis v. Van Camp Packing Co.* 189 Iowa 775, 176 N.W. 382 (1920).
[68] See examples *Baxter v. Ford Motor Co.,* 168 Wash. 456, 12 P.2d 409, aff'd per curiam on rehearing, 15 P.2d 1118 (1932), aff'd on second appeal, 179 Wash. 123, 35 P.2d 1090 (1934), Maecherlein v. Sealy Mattress Co., 145 Cal. App. 2d 275, 302 P.2d 331 (1956); Roberts v. Anheuser-Busch Brewing Ass'n, 211 Mass. 449, 98 N.E. 95 (1912); Rogers v. Toni Home Permanent Co., 167 Ohio St. 244, 147 N.E.2d 612 (1958).
[69] See examples Seely v. White Motor Co., 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965), Santor v. A & M Karagheunsian, Inc., 44 N.J. 52, 207 A.2d 305 (1965); Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 161 A.2d 69 (1960).
[70] Sullivan, above n 59, 372.
[71] Also known as the National Conference of Commissioners on Uniform State Laws (NCCUSL) <http://www.uniformlaws.org/Default.aspx>.
[72] 15 U.S.C § 41.

the source of consumer protection policy in the USA at the federal level, along with ad hoc policy statements made by the FTC in response to authoritative enquiry.[73] In parallel with the introduction of the FTC and its ongoing development was the ongoing procession in courts of actions relating to warranty, both express and implicit.

> A significant change occurred with the celebrated case of *Henningsen v. Bloomfield Motors.* In *Henningsen* the plaintiff suffered serious physical injury when an automobile manufactured by Chrysler Corporation and purchased from a local dealer went out of control. The plaintiff had signed a form sales contract used generally in the automobile industry that included narrowly drawn express warranties. Implied warranties had been completely disclaimed. The court refused to give literal effect both to the warranty clauses and to the disclaimer provision in the seller's form, noting that the disputed clauses were not part of a freely bargained contract but were part of a standardized form "in which one predominant party will dictate its law to an undetermined multiple rather than to an individual".[74]

With the decision in *Henningsen* and further movements towards consumer protections such as unconscionable conduct against suppliers, the courts were gathering pace to further support the contents of Article 2 UCC. There was still concern over the ambiguity of warranties made during the sales process at the federal level. "On February 6, 1968, President Johnson created the Task Force on Appliance Warranties and Service. The Task Force was directed to undertake a study relating to the servicing, repair and durability of consumer products".[75]

Ultimately, the Magnuson-Moss Warranty Act[76] was introduced and it relies on three distinct mechanisms. Firstly, it relies on an extensive disclosure regime to make sure there are unambiguous and readily available details for the consumer about any express warranty. Second, it sets minimum standards with regards to wording of the warranty and whether the warranty is

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[73] Spencer Weber Waller et al, 'Consumer Protection in the United States: An Overview' (2011) May *European Journal of Consumer Law* , 3.
[74] Sullivan, above n 59, 386, referring to Henningsen v. Bloomfield Motors, Inc.,32 N.J. 358, 161 A.2d 69 (1960).
[75] Robert C Denicola, 'The Magnuson-Moss Warranty Act: Making Consumer Product Warranty a Federal Case' (1975) 44(2) *Fordham Law Review* 273, 273.
[76] Title I of the Magnuson-Moss Warranty-Federal Trade Commission Improvement Act, Pub. L. No. 93-637, 88 Stat. 2183 (1975) (Title I codified at 15 U.S.C.A. §§ 2301-12 (Supp. 1, 1975)).

designated “full” or “limited”, and severely limits the use of disclaimers regarding implied warranty. Thirdly, the Act includes detailed enforcement procedures and remedial rights for the consumer.[77]

With regards to implied warranties, the UCC includes a detailed section 2 with similar warranties (or guarantees) to that of the Australian Consumer Law such as merchantability[78] (now acceptable quality s54 ACL), fitness for a particular purpose[79] (s55 ACL), and express warranties by affirmation, promise, description, sample[80] (s56-57,59 ACL). In an extensive article,[81] Timothy Davis clarifies that Article 2 UCC contains controls and remedies for both contract and warranty. Importantly, he also clarifies that any warranty conditions that are implied in a contract, can only be claimed against (a) once the goods have been accepted, and (b) within the twelve month statute of limitations (contrasting with contracts, which can be claimed against within the four year period as per § 2-725 UCC). Express warranty statements may state a period of time, such as twenty years[82], which will be the timeframe, from acceptance of the goods, in which a claim can be made. The UCC and the Magnuson-Moss Act do allow warranty terms to be disclaimed, but those disclaimers must be made very conspicuous to the consumer.[83] There are, therefore, quite a number of pieces of legislation at the federal level and more at the state level to protect consumers.

As mentioned above, policy development appears to be at the federal level, resting with the FTC and the FTC Act. Additionally, the USA is a member of the Organization for Economic Cooperation and Development (OECD) and at one point, one of the Commissioners of the FTC also served “as Chair of the Committee on Consumer Policy”.[84] According to one the many ad hoc policy

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[77] Denicola, above n 69, 274.
[78] U.C.C. § 2-314.
[79] U.C.C. § 2-315.
[80] U.C.C. § 2-313.
[81] Timothy Davis, 'UCC Breach Of Warranty And Contract Claims: Clarifying The Distinction' (2010) 61(3) *Baylor Law Review* 783.
[82] *Medical City Dallas, Ltd. v. Carlisle Corp.,* 251 S.W.3d 55, 57 (Tex. 2008).
[83] § 2-316 UCC.
[84] Timothy J Muris, 'The Interface of Competition and Consumer Protection' (Paper presented at the The Fordham Corporate Law Institute’s Twenty-Ninth Annual Conference on International Antitrust Law and Policy, New York City, 21 October 2002), 17.

statements delivered by the FTC,[85] "unjustified consumer injury[86] is the primary focus of the FTC Act". Furthermore,

> To justify a finding of unfairness the injury must satisfy three tests. It must be substantial; it must not be outweighed by any countervailing benefits to consumers or competition that the practice produces; and it must be an injury that consumers themselves could not reasonably have avoided.

To clarify the first requirement, assuming that the harm is of an economic nature, "an injury may be sufficiently substantial, however, if it does a small harm to a large number of people, or if it raises a significant risk of concrete harm".[87] The liquidation of a company would raise a significant risk of concrete harm. The second test considers whether the injury would not be outweighed by any consumer or competitive benefits. That would be a clear no. And lastly, the injury must be one the consumer could not have easily avoided. Clearly, liquidation of a supplier is out of the control of a consumer.

As a further measure, the policy statement also takes into account whether the action of the company violates public policy, allowing the FTC to establish some analysis of net harm and whether to address the issue with its resources.[88]

3.3 European Union – creation

History tells us that for many centuries there was always a war occurring in some part of what is now known as greater Europe. In years BC and early years AD the Romans were invading and occupying large parts of Europe. In more recent times the French Revolution and Napoleonic Wars were ongoing for almost twenty-five years.[89] An attempt to bring peace to Europe was first negotiated at the Congress of Vienna from November 1814 until June 1815. The congress was a meeting of ambassadors from the powers of Europe, but mainly those from Austria, Britain, France, Russia and Prussia. Mostly

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[85] Federal Trade Commission, 'FTC Policy Statement on Unfairness' (1980) <https://www.ftc.gov/public-statements/1980/12/ftc-policy-statement-unfairness>.
[86] Ibid: the statement offers 'the consumer who may be injured by an unfair trade practice' to clarify the use of the term 'injury'.
[87] Ibid.
[88] Ibid.
[89] Peter Burke, *Popular Culture in Early Modern Europe* (Ashgate Publishing Ltd, 2009).

informal discussions led to the development of treaties and the formation of a framework for European international politics.[90]

On-going development of European integration took a backwards step with the onset of the two World Wars. At the end of those wars Europe realised that it wasn't necessarily the great power it once thought it was with the recent surge of influence from the USA and the Soviet Union. The contemporary idea of the European Union was first prompted by Winston Churchill at the start of the Second World War, but was rejected by the French cabinet.

> Then, in a speech to the University of Zurich on 19 December 1946, Winston Churchill relaunched the idea of European Union, a Union mainly to be founded on a Franco-German base, and at the Hague Congress in May 1948 the European Movement was founded.[91]

The first step towards economic cooperation was the creation of what is now known as the Organisation for Economic Cooperation and Development (OECD), which managed the aid offered by the USA. The next major advancement was the creation of the European Coal and Steel Community (ECSC) established by the Treaty of Paris in 1951.[92] The treaty was signed only by France, Germany, Italy, Belgium, the Netherlands and Luxembourg and for a definitive period of fifty years, which expired in 2002. This treaty included the formation of governing bodies with some of the powers of the Member States. This was the dawning of the European Community where member states were to give up some of their sovereign powers for the greater good of the whole. Subsequently, there were many negotiations and many treaties signed such as those formulated in Rome (1957), Maastricht (1993), Amsterdam (1999), Nice (2003) and Lisbon (2009), and they have continued to shape, restructure and develop the European Community into the current European Union (EU). As the EU developed, so too did the membership of the EU which now encompasses 28 Member states:[93]

Austria, Belgium, Bulgaria, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia,

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[90] Ibid.

[91] Margot Horspool and Matthew Humphreys, *European Union Law* (Oxford University Press, 6th ed, 2010), 3.

[92] Ibid 4.

[93] European Union, *EU member countries in brief* (12 March 2018) European Union <https://europa.eu/european-union/about-eu/countries/member-countries_en>.

Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden and the United Kingdom.

3.3.1 EU Legal system

The treaties and other signed instruments have over time allowed the formation of various institutions that administer the EU.[94] The *European Council*, along with a full-time President, defines the general political priorities and is also the external interface with the rest of the world. The *Council* is the legislative arm of the EU and takes advice and recommendations from the European Council, the Commission, and the European Parliament.[95] The *Commission* carries out the EU decisions, somewhat like the executive arm of the Australian parliament.

The *European Parliament* does not have any legislative powers, but does work in tandem with the Council to develop 'domestic' legislation and also has strong influence and final say over international treaties and legislation. The European Parliament develops the budget for the EU.[96]

The *European Court of Justice* (ECJ) consists of the Court of Justice, the General Court and specialised courts and is, overall, tasked with ensuring "that in the interpretation and application of the Treaty the law is observed".[97]

Member States of the EU, through the various treaties, have conferred certain powers to the EU, but also retained the great majority. It is noted that Article 5 of the Treaty of the European Union (TEU) makes the principles of subsidiarity and proportionality prominent. Simply put, the Union can only make laws over the areas that "fall within its exclusive competence"[98] unless it can be shown that by doing so it would achieve a better outcome than seeking the Member States to do so individually.

In terms of hierarchy of authority, the following are the sources of law in the EU:[99]

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[94] Ramses A Wessel, 'Revisiting the International Legal Status of the EU' (2000) 5(4) *European Foreign Affairs Review* 507.
[95] Ibid.
[96] European Union, above n 92.
[97] Ibid 74.
[98] Ibid 27.
[99] Ibid 104.

Constitutive Treaties
Subsidiary Conventions
EU Regulations
(All of the above are binding in all Member States and do not have to be incorporated into National laws)
EU Directives
EU Decisions
International Agreements
Case law of the Court of Justice
Recommendations and opinions by the ECJ
Member state legislation

EU Directives "are *binding* as to the *effect* to be achieved but leaves the choice as to form and method to the Member States. Directives therefore need to be incorporated into national law and are a more flexible instrument of Union law than regulations, which leave no discretion for any consideration of national differences and needs".[100] The ECJ therefore, hears matters relating to the interpretation of Treaties, Conventions, Regulations and Directives, whilst national courts hear matters relating to their respective national laws. Court of Justice case law precedents apply in all national courts.[101]

National courts can refer matters to the ECJ for interpretation; however, the court "must be convinced that the matter is equally clear to the courts of other Member States which have different legal systems and different techniques of interpretation, and to the Court of Justice bearing in mind the peculiar characteristics of Union law, the different language versions, the Union terminology and the contextual understanding of Union law".[102] This raises the clear issue that within the EU there are different legal systems and different languages, which lends quite a complication to any comparison of laws and reasoning with other countries.

3.3.2 EU - Consumer Protection Policy & Law

[100] Ibid 114.
[101] Geoffrey Garrett, 'The politics of legal integration in the European Union' (1995) 49 *International Organisation* 171.
[102] European Union, above n 92, 92.

The discussion regarding the history of consumer protection in the EU will be limited here to that of the EU and its origins. Several of the many goals to be achieved with the formation of the European Economic Community (EEC) were to allow freedom of movement of persons within and between Member States, free movement of workers between Member states and free movement of goods between Member States. Additionally, with those elements in place, the EEC also became a Single European Market, a Common Market and now, an Internal Market.[103] With the initial objective to create this Internal Market came policies and regulations that were focused on productivity and competition. Focus was given to ensuring better produce was available, and more products manufactured by a greater number of manufacturers, which in turn was said to be better for the consumer as they had more choice, more freedom of choice, and competition would provide better goods at more competitive pricing.[104] Whilst consumer groups actively canvassed the formulation of consumer protection laws, the EU was unable to make any directives with regards to consumer protection, as it was repugnant to the principle of subsidiarity. There was at least one directive that was implemented with consumer protection in mind and that was Directive 90/314/EEC of 13 June 1990. That directive was implemented to safeguard consumers, mainly tourists, from the possible insolvency of a supplier of package travel, package holidays or package tours.

The Maastricht Treaty of 1993 did however include articles that supported the consumer policy measures taken by Member States with regards to consumer protection.[105]

A step forward came with the Treaty of Amsterdam in 1999 where the term 'subsidiarity' was essentially watered down and the treaty gave the EU capacity to "apply flexible instruments in areas not exclusively subject to its powers – such as consumer policy – and to give preference to directives over regulations".[106] A number of directives have been implemented focusing on sales and contract of sales aspects, including Directive 93/13/EC regarding the elimination of unfair terms in consumer contracts, Directive 2008/48/EC

[103] Norbert Reich et al, *European Consumer Law* (Intersentia, 2nd ed, 2014), 6.
[104] Ibid 9.
[105] Ibid.
[106] Ibid 13.

regarding consumer credit, and Directive 94/47/EC which protects purchasers in respect of certain aspects of contracts relating to timeshares.[107]

Most important was "Directive 1999/44/EC on the sale of consumer goods and associated guarantees, which was adopted on 20 May 1999. Member States were required to implement it into their national laws by 1 January 2002".[108] This Directive applies to contracts for consumer goods that are defined in Article 1(2)(b) as "any tangible movable item" either existing or to be manufactured (Article 1(4)). The *consumer* is defined as "any natural person who, in the contracts covered by this Directive, is acting for purposes which are not related to his trade, business or profession" (Article 1(2)(a)). The *seller* is defined in Article 1(2)(c) as "any natural or legal person who, under a contract, sells consumer goods in the course of his trade, business or profession".

Article 2 of the Directive provides that the seller must deliver goods to the consumer that conform to the contract of sale. That means the goods must match the description of the goods, a sample provided, or the model given (Article 2(2)(a)). The goods must be fit for a particular purpose the consumer has articulated (Article 2(2)(b), or that which might normally be associated with the goods (Article 2(2)(c)). If there are public statements (usually through advertising) made about the goods, the goods delivered must conform to those statements, and the goods must be of a quality expected of that type of good (Article 2(2)(d)).

The consumer can expect to have the goods brought into line of conformity at no cost either by repair or replacement at the consumer's discretion, allowing for proportionality of cost to the seller (Article 3(3)). The seller should bear all costs associated with the repair or replacement including such items as postage, labour or materials (Article 3(4)). Article 5(1) holds the seller liable to the consumer where any non-conformity is not immediately apparent, for a period of two years. The consumer must notify the seller within a period of two months after discovering any non-conformity (Article 5(2)).

Article 1(e) defines that a guarantee

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[107] Ibid 36.
[108] Ibid 169.

> shall mean any undertaking by a seller or producer to the consumer, given without extra charge, to reimburse the price paid or to replace, repair or handle consumer goods in any way if they do not meet the specifications set out in the guarantee statement or in the relevant advertising.

Article 6 enforces any guarantee made by the seller to the consumer and stipulates that the guarantee must "set out in plain intelligible language the contents of the guarantee and the essential particulars necessary for making claims under the guarantee, notably the duration and territorial scope of the guarantee as well as the name and address of the guarantor" (Article 6(2)). Article 6(2) also ensures that the rights expressed by the applicable national law will not be affected by the guarantee. Article 7(1) further ensures that any contract terms or agreements that may attempt to limit any rights provided for by national law, will not be binding for the consumer.

To summarise, there is a statutory provision of two years in which a consumer may inform the seller that the goods do not conform to the contract either by way of description, sample or design, by fitness for particular purpose, fitness for normal use, normal quality for that type of good, or by a guarantee specifically nominated. Furthermore, the specific guarantee may nominate a timeframe that is longer the statutory period. Statutory provisions and rights cannot be disclaimed.

3.4 Comparative Analysis

In order to facilitate comparison, this section will summarise the main features of the consumer protection laws that affect the class of people who have active entitlements. Whilst the comparison of the elements below are valued in their own right, it would be prudent to qualify the various structures of government within the three comparative jurisdictions. Some preliminary definitions include:[109]

[109] Encyclopedia Britannica, "Confederations and federations" Encyclopedia Britannica <https://www.britannica.com/topic/political-system/Confederations-and-federations>.

> Confederations are voluntary associations of independent states that, to secure some common purpose, agree to certain limitations on their freedom of action and establish some joint machinery of consultation or deliberation.
>
> The term *federation* is used to refer to groupings of states, often on a regional basis, that establish central executive machinery to implement policies or to supervise joint activities.

The European Union (EU) is a supranational organization that, while resisting strict classification as either a confederation or a federation, has both confederal and federal aspects. Prior to the construct of the EU, the European Communities quickly developed "executive machinery exercising significant regulatory and directive authority over the governments and private business firms of the member countries." [110] However, each of the member governments retains a substantial measure of national sovereignty—an important aspect of confederal arrangements. The government arrangements in Australia are that of a federal system and the constitution has divided the legal authorities and powers between the federal level and state levels. As stated, the following comparisons remain valid regardless of the government structures.

3.4.1 Consumers

Firstly, it is important to understand the specific class, or group, of people who may be affected by, or may need to seek relief under, the consumer protection laws.

The ACL is legislation created at the federal level. State level legislation[111] defers to the ACL. The ACL defines that class as *consumers* and they may be either those who purchase goods of a type used for domestic, household or personal use, or, those who purchase products up to a value of $40,000 that are not used for manufacture or resale.[112] A person can be a natural human being or a legal entity.

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[110] Ibid.
[111] See for example *Fair Trading Act 1989* (Qld).
[112] Australian Consumer Law s3; note that the limit of $40,000 was increased to $100,000 as of 1 July 2021.

The UCC is legislation enacted at the state level by all states of the USA in much the same form. There is no federal level legislation covering the warranty specifically. The UCC uses the term *buyer* meaning a "person who buys or contracts to buy goods".[113] Goods are defined as all things that are "moveable at the time of identification to the contract of sale".[114] These definitions create a class of people much wider than that under the ACL.

In the European Union, a *directive* compels all member states to include those rules as a minimum into their own national legislation. Legislation regarding consumer protection is included in many directives, but quite specifically with regards to warranty in Directive 1999/44/EC. In that directive, *consumer* "shall mean any natural person who, in the contracts covered by this Directive, is acting for purposes that are not related to his trade, business or profession; and *consumer goods* means any 'tangible moving item'.[115]

The EU definitions are similar to those of Australia and create a smaller class than that of the USA.

3.4.2 Guarantees

Each entity has similar guarantees in terms of "acceptable quality", "supply of goods by description" and "supply of goods by sample or demonstration model"[116] as in Australia, or "merchantable", "match by description" or "sample" in the USA[117], or "comply with the description" or those goods shown as samples or models in the EU.[118]

They all have a guarantee with regards to fitness for purpose for an article of that type[119] and also "fitness for any disclosed purpose".[120] Express warranties in Australia are covered under s59 ACL with no other specific legislation. In the USA express warranties must be worded in accordance with

[113] UCC § 2-103.
[114] UCC § 2-105.
[115] Directive 1999/44/EC Article 1(2).
[116] Australian Consumer Law s54, 56, 57.
[117] UCC § 2-313, 2-314.
[118] Directive 1999/44/EC Article 2(2)(a).
[119] Australian Consumer Law s54, UCC § 2-314 (2)(c), Directive 1999/44/EC Article 2(2)(c).
[120] Australian Consumer Law s55, UCC § 2-315, Directive 1999/44/EC Article 2(2)(b).

specific legislation[121] and supported by UCC § 2-313. In the EU, express warranties are covered by Article 6 in Directive 1999/44/EC.
In the USA it is possible for the supplier to exclude or modify warranties under UCC § 2-316 but not to the extent that it is 'unreasonable'. Both Australia and the EU do not allow exclusion or modification of statute guarantees.[122]

3.4.3 Time limits

All three jurisdictions enforce the terms of an express warranty.[123]
With regards to implied warranties, there is a difference between all three jurisdictions. In Australia there is no clear length of time within which a consumer may 'reject goods' and certain elements must be considered such as:[124]

> (a) the type of goods; and
> (b) the use to which a consumer is likely to put them; and
> (c) the length of time for which it is reasonable for them to be used; and
> (d) the amount of use to which it is reasonable for them to be put before such a failure becomes apparent.

The USA confines the time to reject goods to within the statute of limitations period of twelve months[125], whilst the EU has a fixed period of two years.[126]

3.5 Consumer Protection Summary

In summary, under government guarantees, the consumer who has purchased goods and discovers an issue with the goods under the given guarantees may make a claim within the time periods established. Claims must be made to the supplier, if they are trading at the time the fault is discovered. Consumers who have entered into a purchase contract and either

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121 Title I of the Magnuson-Moss Warranty-Federal Trade Commission Improvement Act, Pub. L. No. 93-637, 88 Stat. 2183 (1975) (Title I codified at 15 U.S.C.A. §§ 2301-12 (Supp. 1, 1975)).
122 Australian Consumer Law s64, Directive 1999/44/EC Article 7(2).
123 Australian Consumer Law s259(2)(c), UCC § 2-725 (2), Directive 1999/44/EC Article 6.
124 Australian Consumer Law s262(2).
125 Davis, above n 75.
126 Directive 1999/44/EC Article 5(1).

not yet received their purchased goods or hold gift cards to allow future purchases should also expect the terms of the sale contract to be executed in full.

What happens when a company ceases to trade? The following Section reviews the relevant legislation in the jurisdictions of Australia, United States of America and the European Union to understand what remedy or relief a consumer may have with regards to their active entitlements at the time of insolvency.

3.6 Insolvency Law Introduction

When a company comes to the point where it will cease to trade, either voluntarily or by actions of others, there are formal processes to follow.[127] In Australia companies are regulated by the *Corporations Act 2001* (Cth), which not only dictates how they should conduct themselves in business, but also how that business will ultimately be dealt with. Individuals, who get to the point of not being able to pay their bills as and when they are due, are subject to the *Bankruptcy Act 1966* (Cth). This includes sole traders who are not incorporated and therefore not subject to the *Corporations Act 2001* (Cth).[128]

Importantly, these pieces of legislation determine what happens to external parties who may have a claim against the defaulting entity.

This section reviews the legislative landscape in each of the three jurisdictions Australia, United States of America and the European Union. A consumer with active entitlements may either have a claim to make at the point in time the company enters the insolvency process, or may have a remaining warranty period in which to make a claim. The latter claim could be lodged well after the process of insolvency has been finalised. It is therefore imperative to understand what capacity the consumer in those circumstances may have to make a claim within the legislative processes of insolvency in each jurisdiction.

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[127] Christopher Symes and John Duns, *Australian Insolvency Law* (LexisNexis Butterworths, 2012).

[128] Ibid.

To understand the regime in place today, it is important to recognise and appreciate the historical development of insolvency law, as the focus has always been on dealing with the company and its main creditors, rather than focusing on consumer issues.

3.6.1 Australia - Insolvency Law – History

Australian insolvency law, like all other laws, came with the British immigration to Australia. In a lecture[129] to the Francis Forbes Society for Australian Legal History, the Honourable T. F. Bathurst, then Chief Justice of New South Wales, discussed the historical development of insolvency law. His honour spent some time describing how even at the time of the Romans BC people had to pay debts, although that may not have been from borrowing money. The early Italian statutes allowed transactions to occur a week prior to be voided if necessary. In the early thirteenth century those who could not repay debts either lost their assets to pay creditors or were imprisoned, or both. The speech by Bathurst was very detailed and clearly indicated that communities through time have handled the inability to pay debts in many different ways.

The terms *insolvency* and *bankruptcy* today mean different things, but that was not always so. The term *bankrupt* was first used in English law in 1542 in the title of an act of Parliament[130] where that act, and another one later that century, were related only to tradesmen outlining a process "for the collection and proportional distribution of a trader's assets between all creditors".[131] The term *insolvency* arose in the eighteenth century for similar purposes but for a very different group of people. Tradesmen were seen as lowly compared to non-traders or gentlemen business people, and therefore gentlemen may have been insolvent, but never bankrupt. That distinction, however, was removed in 1861 when the laws for each were combined and bankruptcy was limited to personal insolvencies.[132] As the growth of the Industrial Revolution

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[129] The Hon T F Bathurst, 'The Historical Development Of Insolvency Law' (Paper presented at the Francis Forbes Society For Australian Legal History Introduction To Australian Legal History Tutorials, Sydney, 3 September 2014).
[130] *An Act Against Such Persons as Do Make Bankrupt* (1542) 34 & 35 Henry VIII, c 4.
[131] Bathurst, above n 109, 3.
[132] Ibid.

continued, so too did the number of insolvencies as credit became available to, and misused by, uneducated businessmen. Prior to 1844, when a company became insolvent the directors and the members (shareholders) were held accountable. In 1844 insolvent companies were sent to the Bankruptcy Court, which treated the company as an entity and did not include individual members.[133] This was further assisted by the introduction of the Companies Act in 1862, clearly making the distinction between company and individual insolvency.

Those laws carried across to Australia from 1788 and in 1823 the Supreme Court of New South Wales was "expressly vested with insolvency jurisdiction".[134] Due to the local issues experienced in the new colony, insolvency laws were re-drafted, notably with the option to discharge a debtor if the majority of the creditors agreed. This applied to company and individual insolvents. During the period until federation, insolvency laws were developed in each state and were quite divergent, causing issues where assets were in different states.

> At federation the Commonwealth was given power to legislate with respect to "bankruptcy and insolvency" per s 51(xvii) of the Constitution. Here the importance of terminology again is self evident. Despite the term "insolvency", the restrictive interpretation of the Commonwealth's corporation power by the High Court meant the insolvency of companies, was dealt on a state by state basis even after Federation.[135]

Although there were attempts to make unifying bankruptcy laws, it was not until 1966 that the Bankruptcy Act came into being. The states were still dealing with company insolvencies based on their own version of a Companies Act, mainly updated from England. Ultimately the states referred their power to the Commonwealth, which then allowed the introduction of the current *Corporations Act 2001* (Cth). Both bankruptcy laws and company insolvency laws now both operate at the federal level and are consistently applicable to all within Australia. The most significant review of the insolvency

[133] Ibid 16.
[134] Ibid 18.
[135] Ibid 20.

and bankruptcy laws was the 1988 Harmer Report[136]. Up until that time the main focus of insolvency (and bankruptcy) was to wind up the company. One of the many recommendations from that report was to include 'voluntary administration' which gave the company some time to look at restructuring and consider continuing to trade.[137] A recommendation considered, but not actually tabled, was to combine both bankruptcy and insolvency law into one, which has been done in Canada, the USA and also the United Kingdom.[138]

3.6.2 Australia - Insolvency Law – Policy

In 2004, the Parliamentary Joint Committee (PJC) on Corporations and Financial Service issued a report titled "Corporate Insolvency Laws: a Stocktake".[139] That report detailed the policies, principles and objectives, at that time, which still shape the development of insolvency legislation in Australia. They referred to the Harmer Report, which suggested the fundamental objective for insolvency law was "to provide a fair and orderly process for dealing with the financial affairs of insolvent individuals and companies".[140] Notably, another objective was that "the end result of an insolvency administration should be the effective relief or release from the financial liabilities and obligations of the insolvent". Additionally, the PJC considered a statement by the World Bank[141], which also offered policies including "an efficient system for enforcing debt claims [which] is crucial to a functioning credit system, especially for unsecured credit". The approach in the PJC's review consolidated many of the policies and objectives from various sources and the Committee has placed importance on the following objectives and values:[142]

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136 General Insolvency Inquiry [1988] ALRC 45; Mr Harmer was Commissioner-in-charge.
137 Michael Murray and Jason Harris, *Keay's Insolvency: Personal and Corporate Law and Practice* (Lawbook Company, 7th ed, 2011), 9.
138 Ibid 10.
139 Parliamentary Joint Committee on Corporations and Financial Services, 'Corporate Insolvency Laws: a Stocktake' (2004) (PJCCFS).
140 ALRC, above n 116, 33.
141 World Bank, Principles and Guidelines Effective Insolvency and Creditor Rights Systems, April, 2001 available at http://www.worldbank.org/ifa/ipg_eng.pdf.
142 PJCCFS, above n 119, 21.

1. encouraging early intervention in the affairs of companies in financial difficulties and restoring companies to profitable trading where practicable;
2. striking a balance between voluntary administration and liquidation;
3. protecting the interests of creditors and, in particular, employees in circumstances of financial difficulty and corporate malpractice;
4. maximising the value of an insolvent company's assets;
5. reducing the cost of credit; and
6. encouraging the good management of companies and deterring malpractice and, in particular, abuses of the corporate form and insolvency procedures generally.

It can be clearly seen that even from its earliest incarnation the principal objectives of insolvency law have been to (a) protect the interests of creditors, (b) to release the debtor from any further liability as soon as possible and, more recently, (c) to assist a failing company to restructure and continue trading wherever possible.
There is no policy statement regarding the holder of active entitlements.

3.6.3 Australia - Insolvency Law – Legislation

The legislation covering company insolvency is included as Chapter 5 of the *Corporations Act 2001* (Cth). The title of the chapter is 'External Administration' which is defined in s600H(2) as including:

(a) voluntary administration;
(b) a compromise or arrangement under part 5.1;
(c) administration under a deed of company arrangement;
(d) winding up by the Court;
(e) voluntary winding up.

There is separate legislation for individuals in the *Bankruptcy Act 1966* (Cth). The general principles, objectives and many of the processes and outcomes in both, however, are similar.[143] It should also be noted that whilst Chapter 5[144] does cover companies, there are some entities that have specialised

[143] Murray and Harris, above n 117, 9.
[144] *Corporations Act 2001* (Cth).

insolvency legislation, including insurance companies (*Life Insurance Act 1995* (Cth)), Aboriginal corporations that have particular winding up provisions in the *Corporations (Aboriginal and Torres Strait Islander) Act 2006* (Cth), and some entities (cooperatives and associations) that are subject to State and Territory laws.[145]

For simplicity, this discussion will refer only to company insolvency; however, it must be noted that as at June 2016 there were 561,033 sole proprietors operating alongside 804,186 companies, 276,303 partnerships and 529,606 trusts.[146] Additionally, of the 607,320 sole proprietors operating as at June 2012 only 310,011 had survived (51.0%) by June 2016. Of the 726,921 active companies as at June 2012, 472,512 had survived (65.0%), with 63.7% of partnerships and 70.5% of trusts surviving in the same period.

The definition of insolvency is 'the state of not being solvent'. The definition of solvent at s95A[147] states that:

> (1) A person is solvent if, and only if, the person is able to pay all the person's debts, as and when they fall due and payable.
>
> (2) A person who is not solvent is insolvent.

This definition, seemingly succinct, has been challenged in court[148] where it may include not only the cash flow test, as defined in s95A, but also a 'balance sheet' test, which considers the assets of the company against its overall liabilities. However it was considered that if there were assets that were not available to be liquidated to pay current debts then the person remained insolvent. Given the uncertain trading patterns of many companies, the decision about whether a company is solvent on any one particular day can be somewhat imprecise.[149] Confirming the test as stated in s95A, the court in *Crema Pty Ltd v Land Mark Property Developments Pty Ltd* (2006) 58 ASCR 631, 652 stated:

> Section 95A of the Act enshrines the cash flow test of insolvency which, in contrast to a balance sheet test, focuses on liquidity and the viability of the

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145 Murray and Harris, above n 117, 13.
146 Australian Bureau of Statistics, 8165.0 - Counts of Australian Businesses, including Entries and Exits, Jun 2012 to Jun 2016 (21 February 2017) <http://www.abs.gov.au/ausstats/abs@.nsf/mf/8165.0>.
147 *Corporations Act 2001* (Cth).
148 Re Tweed Garages Ltd [1962] Ch 406, 410.
149 Murray and Harris, above n 117, 18.

> business. While an excess of assets over liabilities will satisfy a balance sheet test, if the assets are not readily realisable so as to permit the payment of all debts as they fall due, the company will not be solvent. Conversely, it may be able to pay its debts as and when they fall due, despite a deficiency of assets.

It is of some significance that s95A uses the term 'debts' rather than 'claims', a term used in s553[150] to discuss provable debts. Again, a court[151] decision confirmed that a debt is a liquidated sum of money and "refers to an agreement by the parties to the calculation of a precise amount". Furthermore, "a debt is incurred when the debtor acts in such a way as to give rise to a legal obligation to pay a sum of money in the future, even if the obligation is contingent on one or more events happening".[152]

From the point of view of a consumer wishing to deal with a company, there is very little information available that may provide the consumer with knowledge that the company may not be financially stable. There is a statutory requirement [153] that the directors of a company, annually, formally acknowledge whether the company is solvent or not. This information, including financial reports, is only available to the public for public companies,[154] not for proprietary limited, or private companies. The majority of companies in Australia are private companies.[155] Furthermore, there are a number of indicators that a company may be heading towards, or is experiencing insolvency, yet none of these would necessarily be available to the consumer. "Commonly regarded indicators of insolvency, as established in *ASIC v Plymin* (2003) 46 ACSR 126 include:

- Continuing losses
- Liquidity ratio below 1.0
- Overdue Commonwealth & State taxes and Statutory obligations
- Poor relationship with present bank including inability to borrow additional funds

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150 *Corporations Act 2001* (Cth).
151 *Rothwells Ltd v Nommack (No 100) Pty Ltd* [1990] 2 Qd R 85.
152 Murray and Harris, above n 117, 21.
153 *Corporations Act 2001* (Cth) s347A.
154 *Corporations Act 2001* (Cth) Chapter 2M; this chapter does provide for some exceptions.
155 Australian Bureau of Statistics, above n 126.

- No access to alternative finance
- Inability to raise further equity capital
- Supplier placing the debtor on 'cash-on-delivery' (COD) terms, or otherwise demanding special payments/arrangements before resuming supply
- Creditors unpaid outside trading terms
- Issuing of post-dated cheques / dishonoured cheques
- Payments to creditors of rounded figures, which are irreconcilable to specific invoices
- Solicitors' letters, summons(es), judgments or warrants issued against the company
- Inability to produce timely and accurate financial information to display the company's trading performance and financial position, and make reliable forecasts."[156]

"[W]hile the most prevalent reason for liquidation is insolvency",[157] companies can go through the process of voluntary liquidation under Part 5.5 of the Corporations Act.[158] These companies may, or may not, be insolvent. With insolvent companies, or those characterised by some of the indicators above, it is most likely that a creditor will instigate formal proceedings.

3.6.3.1 Voluntary Administration

As mentioned, one of the many changes to insolvency law recommended by the Harmer Report was the introduction of the 'voluntary administration' regime. If a company is realising that a number of the indicators above are occurring they have the opportunity to enter into voluntary administration. The main aims of voluntary administration is to allow a company to call in a qualified insolvency practitioner who would take over the affairs of the company with the goal of trading out of the dilemma being experienced. This process would usually take the form of the administrator contacting the

[156] Cor Cordis, Insolvency Indicators <https://www.corcordis.com.au/corporate-insolvency/insolvency-indicators/>.
[157] Murray and Harris, above n 117, 278.
[158] Ibid..

relevant creditors and discussing the financial issues with the view of developing a 'deed of company arrangement' (DOCA).[159] The DOCA would regulate the relationship between the creditors and the company. This could take the form of relaxed payment terms, extended funds from a lender based on certain projections, or even the sale of part of the business that may not be core to the company's main objectives. If a viable DOCA cannot be formulated then liquidation would usually result. When a DOCA has been constructed and implemented, all of the prior debts of the company are extinguished, subject to the contents of the DOCA.[160] This particular rule has been the subject of varying discussion and outcomes in several court cases, with parties wishing to understand whether their claim, which has not yet crystallised (warranty holders yet to claim, for example), will be extinguished with the execution of a DOCA or will still be claimable after the date of administration. For present purposes, it is instructive to fully consider the meaning of the term 'creditor' and the classes of entities that are, or are not, included. Warranty holders are one such entity. It has been determined[161] that creditors take the meaning from s553(1)[162], which provides the following:

> *Subject to this Division and Division 8, in every winding up, all debts payable, by and all claims against, the company (present, future, certain or contingent, ascertained or sounding only in damages), being debts or claims the circumstances giving rise to which occurred before the relevant date, are admissible to proof against the company.*

This suggests that even those creditors with a contingent claim may be bound by a DOCA. Is a warranty a contingent claim at the time of administration (or liquidation)?

The NSW Court of Appeal considered the difference between an actual and/or contingent claim and a "mere expectancy".[163] According to the Court:

> *…A contingent creditor is a person to whom a corporation owes an existing obligation out of which a liability on its part to pay a sum of money will arise in*

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159 Ibid 573.
160 *Corporations Act 2001* (Cth) s444D(1).
161 *Brash Holdings Ltd v Katile Pty Ltd* [1996] 1 VR 24.
162 *Corporations Act 2001* (Cth).
163 Heather Collins, 'Does A Deed Of Company Arrangement (Doca) Extinguish Claims By Creditors For Latent Defects?' (2016) (22 March 2016) *Insights* <https://www.cbp.com.au/insights/2016/march/does-a-deed-of-company-arrangement-(doca)-extingui>.

a future event, whether that event be one which must happen or only an event which may happen…

…….a prospective creditor being one who is owed a sum of money not immediately payable but which will certainly become due in the future either on some date which has already been determined or on some date to be determinable by reference to future events...

"In *re Motor Group Australia Pty Ltd* [2005] FCA 985, the Court considered whether a group of persons who purchased a new motor vehicle from the company and had a motor vehicle warranty, but had not made a warranty claim, were contingent or prospective creditors caught by the DOCA. Hely J regarded such persons as being contingent or prospective creditors as at the date of the voluntary administration because warranties had been issued prior to the company being placed in administration, notwithstanding that the liability on the warranty was dependent on the occurrence of later events."[164]

Whilst that may be true, it was eloquently described by Campbell J in the NSW Court of Appeal:[165]

…that the warranty creditors in Re Motor Group would be contingent creditors of the company. There might be big problems in valuing their claims: unless there was a sound statistical basis for estimating the probability that a particular car would turn out to have a defect within the warranty period, and a sound statistical basis for quantifying the likely cost of remedying a defect, the claims might need to be valued at zero or merely a nominal amount. But that does not deny that, as a matter of analysis, they are contingent creditors.

Provable debts will be discussed under liquidation.

3.6.3.2 Liquidation

The liquidation or 'winding up' process, whilst usually initiated by a creditor,[166] can also be initiated by the company itself[167], the members (or

[164] Heather Collins, above n 142.
[165] *BE Australia WD Pty Ltd (subject to a deed of company arrangement) v Sutton* [2011] NSWCA 414.
[166] *Corporations Act 2001* (Cth) s462(1)(b).
[167] *Corporations Act 2001* (Cth) s462(1)(a).

shareholders) [168] , the liquidator (most likely from a failed voluntary administration)[169], or ASIC.[170] The liquidation process is a court ordered process and is usually initiated by a creditor who has not been able to extract monies owing from the company.[171] A liquidator is appointed and must begin the process of realising the assets of the company for the benefit of the creditors and any money left over will be returned to the shareholders, and the company is de-registered.

Whilst that process is underway the liquidator will request that all creditors submit details of the debts owed by the company being liquidated as required under Regulation 5.6.39 (1)[172], which states:

> A liquidator may from time to time fix a day, not less than 14 days after the day on which notice is given in accordance with subregulation (2), on or before which a creditor may submit particulars of his or her debt or claim.

3.6.3.3 Provable debts

Regulation 5.6.40 (1)[173] states that "a proof of debt or claim may be prepared by the creditor personally or by a person authorised by the creditor" and Regulation 5.6.41[174] requires that:

> A proof of debt or claim must state:
> (a) whether the creditor is or is not a secured creditor; and
> (b) the value and nature of the creditor's security (if any); and
> (c) whether the debt is secured wholly or in part.

A consumer with active entitlements of either pre-payments or unused gift cards would have clear provable debt claims as the amount 'owing' on a gift card or the amount of pre-payment are known ascertainable values.[175] The consumer holding a warranty, as stated earlier, is a contingent creditor and

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168 *Corporations Act 2001* (Cth) s462(1)(c).
169 *Corporations Act 2001* (Cth) s462(1)(d).
170 *Corporations Act 2001* (Cth) s462(2)(e)(f).
171 Murray and Harris, above n 117, 284.
172 *Corporation Regulations 2001* (Cth).
173 Ibid.
174 Ibid.
175 *Bankruptcy Act 1966* (Cth) s82(1), (6).

could lodge a proof of debt. However, as articulated earlier by Campbell J[176] referring to *Re Motor Group*, it would be unlikely that a warranty claim for an unknown condition or situation would be of any significant value. Furthermore, should the claim be unvalued, the liquidator has the duty to "make an estimate of the value of the debt or claim as at the relevant date"[177], the relevant date being the date the winding up is taken to have begun.[178] Should the liquidator be required to make a valuation of the claim, the creditor has the option to apply to the court if they disagree with the valuation.[179]

As the regulations require, the claim must specify whether the claim is secured or unsecured. Although the *Corporations Act 2001* (Cth) does not define a 'secured creditor', s5 *Bankruptcy Act 1966* (Cth) does, stating that "in relation to a debtor, [it] means a person holding a mortgage, charge or lien on property of the debtor as a security for a debt due to him or her from the debtor". A consumer with a claim for a pre-payment, unused gift card or warranty claim is not secured, and therefore an active entitlement holder, with a claim, is at best, an unsecured creditor.

3.6.3.4. Priority list

"The rule in liquidations, as with insolvency law in general, is that all company funds should be distributed *pari passu* among the creditors, namely equally and rateably"[180] pursuant to s555 *Corporations Act 2001* (Cth). That section does state "Except as otherwise provided by this Act", which can be seen in s556.[181] This section is a list of which payments should be made in order of priority.

1. Cost of preserving, realizing or getting in the company's assets: s556(1)(a)
2. Taxed cost of the petitioning creditors: s556(1)(b)
3. Costs of any first application for winding up: s556(1)(ba)
4. Voluntary administrator's debts incurred during administration: s556(1)(c)

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[176] *BE Australia WD Pty Ltd (subject to a deed of company arrangement) v Sutton* [2011] NSWCA 414.
[177] *Corporations Act 2001* (Cth) s554A(2)(a).
[178] *Corporations Act 2001* (Cth) s9.
[179] *Corporations Act 2001* (Cth) s554A(3).
[180] Murray and Harris, above n 117, 452.
[181] *Corporations Act 2001* (Cth).

5. Debts incurred by an official manager: s556(1)(d)
6. Costs of preparing a report of the company's affairs: s556(1)(da)
7. Costs of preparing a report by voluntary administrator: s556(1)(daa)
8. Auditor's costs of auditing a liquidator's returns: s556(1)(db)
9. All other costs incurred by liquidator or other insolvency administrators: s556(1)(dd)
10. Deferred expenses: s556(1)(de)
11. Expenses incurred by the committee of inspection: s556(1)(df)
12. Employee wages and superannuation: s556(1)(e)
13. Injury compensation: s556(1)(f)
14. Annual leave and accrued entitlements: s556(1)(g)
15. Redundancy payments: s556(1)(h)
16. Unsecured creditors
17. Interest on creditors' debts accruing after date of liquidation: s563B
18. Members' debts
19. Return of capital

After most of the priority payees, there may be some money to pay the unsecured creditors, but this is highly unlikely.[182] Also, s559[183] insists that all parties, within each of the categories, equally share any amount available.

3.6.3.5 Insurance Policies

Where the company had taken out an insurance policy against liability to third parties, prior to the relevant date,[184] s562[185] ensures that those third parties are paid directly by the insurance underwriter, separately to the priority list above. The liquidator must receive from the insurer any moneys due from the policy, and after deducting any expenses incurred in doing so, make any payment necessary to extinguish any third party debt to the extent any payment will allow.

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[182] Rasiah Gengatharen, 'Protecting the prepaying buyer of goods from the seller's insolvency' (2014) 22 *Insolvency Law Journal* 5.
[183] *Corporations Act 2001* (Cth).
[184] *Corporations Act 2001* (Cth) s9; in relation to a winding up, means the day on which the winding up is taken because of Division 1A of Part 5.6 to have begun.
[185] *Corporations Act 2001* (Cth).

The liability, as described by s562, is that which "is incurred by the company (whether before or after the relevant date)". Given that the amount of money "is received by the company or the liquidator from the insurer" suggests that any policy that may be taken out for the benefit of holders of a warranty's active entitlement into the future would not survive the liquidation process.

3.6.3.6 Termination of Liquidation

At the end of the liquidation process the company is de-registered and no one can act on behalf of the company and all of its debts and obligations are totally extinguished.[186] This means that a warranty holder will not be able to take any action against the company, within the remaining period of the warranty, should they need to make a claim.

3.7 Australia Insolvency Summary

It is clear from this investigation of the insolvency and liquidation processes within Australia that a warranty holder will not be able to realise any benefit from their warranty once a company has entered into the liquidation process. Although the warranty holder may be classed as a contingent creditor, their claim would most likely be valued at zero or close to it due to the unknown potential event that would trigger a claim. If the claim were valued at zero (most likely), there would be no provable debt and therefore they would not be classed as an unsecured creditor. Consumers with active entitlements of pre-payments or unused gift cards, classed as unsecured creditors, would also most likely end up with zero after the liquidation process was completed, especially if there were secured creditors.

The following review of the laws in USA and EU relate to consumers with an active entitlement of an unexpired warranty, as the other active entitlements are both provable debts at the time of insolvency or bankruptcy.

3.8 USA - Insolvency Law – History

[186] Murray and Harris, above n 117, 497.

Given the origins and history of the legal system in the USA, as described earlier in this chapter, it comes as no surprise that bankruptcy laws were based on English laws.[187] Bankruptcy of the individual and insolvency of a company are both known as bankruptcy in the jurisdiction of the USA. Prior to Federation, the States were developing their own versions of bankruptcy laws to suit local conditions. Apparently "no crime brought so many people to the jails and prisons as the crime of debt".[188] When a worker had an accident or fell ill there was no income and they ran up a bill to purchase necessary food and, once better, were taken to jail if they could not pay the bill. "Under the U.S. Constitution, adopted in 1789, bankruptcy law became a federal law in the United States".[189]

The early bankruptcy laws, even at the Federal level, were for the benefit of creditors. There were a series of Bankruptcy Acts enacted and repealed throughout the 1800s.[190] As the industrial revolution developed the economy, demand grew for credit and the balance between debtors and creditors equalised as they both realised they needed each other. In the early 1930s legislation was changed "for the relief of debtors"[191], after demands by both the state legislatures and Federal Congress, and this also included specific legislation for the reorganisation of railroad companies, companies in general and individuals. Over the years the bankruptcy laws were moulded as the economy developed and by 1938 the basis of the laws of today was established. There were options for individuals to either make arrangements to pay debts in part over longer periods of time or sell all of their assets and start again. A similar selection of options was available to companies, and there were even laws specifically for the bankruptcy of municipalities.

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[187] Todd J Zywicki, 'The Past, Present and Future of Bankruptcy Law in America' (2003) 101(6) *Michigan Law Review* 2016.

[188] Emmet Borden, 'Bankruptcy and the Business Man' (1934) 9 *National Association of Referees in Bankruptcy* 36.

[189] Hansen, Bradley. "Bankruptcy Law in the United States". EH.Net Encyclopedia, edited by Robert Whaples. August 14, 2001. <http://eh.net /encyclopedia/bankruptcy-law-in-the-united-states/>.

[190] Ibid.

[191] Borden, above n 164, 37.

In 1978 there was another review of legislation, due to an increase in personal bankruptcies, and the Bankruptcy Code was introduced. Within 'the Code' there are chapters offering bankruptcy processes in various manners:[192]
Chapter 7 is for both individuals and companies entering liquidation.
Chapter 9 is for municipalities to reorganise.
Chapter 11 is for companies that wish to reorganise and continue trading.
Chapter 12 provides debt relief for family farmers and fishermen.
Chapter 13 is for individuals who wish to make payment arrangements.
Chapter 15 filings are for actions that involve parties from more than one country.

3.8.1 USA - Bankruptcy Law – Legislation

Where a company wishes to continue trading, they would file a petition under Chapter 11. Under this process a consumer with a warranty is most likely able to make a future claim.[193] This discussion will focus on the Chapter 7 process that takes a company into liquidation, and aims to ascertain if there is any continued relief for the warranty holder.
The legislation for Bankruptcy procedures resides in Title 11 of the United States Code. Within Chapter 1 section 101, titled 'definitions', there is no definition of bankrupt. There is a definition of 'insolvent' at 11 U.S.C. § 101(32), which states:

> (A) with reference to an entity other than a partnership and a municipality, financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation, exclusive of—
>
> (i) property transferred, concealed, or removed with intent to hinder, delay, or defraud such entity's creditors; and
>
> (ii) property that may be exempted from property of the estate under section 522 of this title;

The test here is whether the assets (at fair value) of the entity will cover the debts of the entity. Notably, this is a different test to that in Australia. For completeness it is worth noting that at 11 U.S.C. § 101(32)(C)(i) the definition

[192] United States Courts, *Bankruptcy* <http://www.uscourts.gov/services-forms/bankruptcy>.
[193] Todd J Zywicki, above n 186.

for insolvency of a municipality relates to generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute, or at subsection (ii), simply "unable to pay its debts as they become due".

In contrast to the Australian system, where a creditor who has exhausted all avenues to obtain monies owed by a debtor has the right to place a company into liquidation,[194] the USA system puts the onus on the debtor to file for Chapter 7. Furthermore, there are certain fees that must be paid before the petition can continue which increases the burden on the debtor. However, the main reason a debtor will file for Chapter 7 is to have all of their debts extinguished after the sale of their non-exempt assets.[195] The debtor must provide a list of creditors and the amount and nature of their claims. This list is used by the bankruptcy clerk to alert creditors that a petition for Chapter 7 has been lodged, and by law they must not continue any lawsuits or other actions to recover monies.[196] "When a chapter 7 petition is filed, the U.S. trustee (or the bankruptcy court in Alabama and North Carolina) appoints an impartial case trustee to administer the case and liquidate the debtor's non-exempt assets".[197] Within 21 to 40 days the case trustee must call a meeting of creditors and the debtor where the debtor must answer questions from all parties regarding the debtors' financial affairs.[198]

Similar to that of the liquidator, the responsibility of the case trustee is to seal all available assets of the debtor and pay the secured debtors, and if there is any money left they will pay unsecured creditors. Unsecured creditors in general will be asked to file a claim by the Bankruptcy Court once it has been notified that there are available assets.[199] In addition, if the debtor is a business, the bankruptcy court may authorize the trustee to operate the business for a limited period of time if such operation will benefit creditors and enhance the liquidation of the estate.[200] The trustee also has powers to look into transactions prior to the filing of the petition and undo transactions that

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194 Christopher Symes and John Duns, above n 126.
195 United States Courts, *Chapter 7 - Bankruptcy Basics*, http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-7-bankruptcy-basics.
196 11 U.S.C. § 362.
197 United States Courts, above n 167; 11 U.S.C. §§ 701, 704.
198 11 U.S.C. § 343.
199 Fed. R. Bankr. P. 3002(c).
200 11 U.S.C. § 721.

may have favoured certain creditors or had the potential for avoidance of paying some creditors.

Section 726 of the Bankruptcy Code provides for the distribution of any proceeds of asset sales in priority and in full before the next level may receive any distribution. If payment cannot be made in full then payment in a class will be made in an equitable fashion.[201]

Distributions are made in the following priority:

1. Secured creditors: 11 U.S.C. § 510.
2. Unsecured claims for domestic support 11 U.S.C. § 517(a)(1)(A) & (B).
3. Administrative expenses of the trustee: 11 U.S.C. § 517(a)(1)(C).
4. Unsecured claims of any Federal reserve bank related loans: 11 U.S.C. § 517(a)(2).
5. A claim arising in the ordinary course of the debtor's business or financial affairs after the commencement of the case but before the earlier of the appointment of a trustee : 11 U.S.C. § 517(a)(3); 11 U.S.C. § 502(f).
6. Wages and salaries and commissions: 11 U.S.C. § 517(a)(4).
7. Employee benefits: 11 U.S.C. § 517(a)(5).
8. Unsecured debts to grain producers or fishermen: 11 U.S.C. § 517(a)(6).
9. Unpaid property arrangements: 11 U.S.C. § 517(a)(7).
10. Unpaid Government taxes: 11 U.S.C. § 517(a)(8).
11. Commitment to Federal depository institutions: 11 U.S.C. § 517(a)(9).
12. Personal injuries caused by the debtor: 11 U.S.C. § 517(a)(10).
13. Interest payable to secured creditors: 11 U.S.C. § 517(b).
14. Other unsecured creditors: 11 U.S.C. § 517(d).
15. Unpaid fines: 11 U.S.C. § 726(4).
16. Other interest accrued: 11 U.S.C. § 726(5).
17. The debtor: 11 U.S.C. § 726(6).

For the purposes of the Bankruptcy Chapters, the term 'creditor' means "entity that has a claim against the debtor that arose at the time of or before the

[201] 11 U.S.C. § 510.

order for relief concerning the debtor".[202] The term 'claim' means "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured".[203]

It is clear that in this instance, if the warranty holder does not have a claim for 'breach of performance' that occurred 'at the time or before the order for relief', they would not have standing as a creditor. A claim for a future potential event would not have standing.

Under 11 U.S.C. § 727, the court will grant the debtor a discharge of all or most debts unless the debtor is not an individual.[204] For corporate bankruptcies the debts remain until relevant statutes of limitations expire.

3.9 European Union - Insolvency – Background and Policy

The 28 Member States of the European Union each have their own historical development of policy and legislation with regards to personal and company insolvency. The development of the EU itself (described generally in Chapter Two), and the current goals that have been set with regards to economic development, have placed a focus on corporate and personal development to be major contributors to that economic development.[205] The policy development with regards to the treatment of insolvency has been largely influenced by those goals.[206] The challenges that face the EU could be seen in many respects as similar to those that the USA considered in its early days. The Member States have their own legislation; however, they vary considerably.[207] As the EU planned to increase its GDP, among many other

[202] 11 U.S.C. § 101(10)(A).
[203] 11 U.S.C. § 101(5)(B).
[204] 11 U.S.C. § 727(a)(1).
[205] European Commission, 'EUROPE 2020 STRATEGY' (3 March 2010) <http://eeas.europa.eu/delegations/belarus/documents/news/president_barrosos_state_of_the_union_2010_en.pdf>.
[206] European Commission, 'COMMISSION RECOMMENDATION of 12.3.2014 on a new approach to business failure and insolvency' (European Commission, 2014) <http://ec.europa.eu/justice/civil/files/insolvency/01_insolvency_recommendation_en.pdf>.
[207] INSOL Europe, 'Study on a new approach to business failure and insolvency – Comparative legal analysis of the Member States' relevant provisions and practices' (12 May 2014) <http://ec.europa.eu/justice/civil/files/insol_europe_report_2014_en.pdf>.

goals, it recognised the need to develop its internal market and ensure there was an even playing field for companies and entrepreneurs. There were real concerns that entities would move their assets and business to a member state "to obtain a more favourable legal position to the detriment of the general body of creditors".[208]

Prior to the specifics regarding insolvency, the EU also had to develop regulations that considered the variances in the jurisdictions of courts, and indeed the enforcement of decisions made by a court of one member state across the other member states. Regulation (EU) No 1215/2012 was the legal instrument that considered the need to contain the issue:[209]

> Certain differences between national rules governing jurisdiction and recognition of judgments hamper the sound operation of the internal market. Provisions to unify the rules of conflict of jurisdiction in civil and commercial matters, and to ensure rapid and simple recognition and enforcement of judgments given in a Member State, are essential.

And therefore:[210]

> In order to attain the objective of free circulation of judgments in civil and commercial matters, it is necessary and appropriate that the rules governing jurisdiction and the recognition and enforcement of judgments be governed by a legal instrument of the Union which is binding and directly applicable.

In developing the policy and strategy for the EU, and in particular the 'convergence of insolvency frameworks within the European Union' the EU Commission requested a number of reports and also embarked on public consultation processes.[211] The results were several reports studying business failure and insolvency within the EU member states, a recommendation by the European Commission, and a specific Regulation.[212]

3.9.1 European Union - Insolvency – Legislation

[208] REGULATION (EU) 2015/848 Recitals 3-5; Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings was first introduced but required improvement.
[209] Regulation (EU) No 1215/2012 Recital 4; also see Rosalind Mason, 'Cross-border Insolvency and Legal Transnationalism' (2012) 21 *International Insolvency Law Review* 105 for an extensive review of this issue.
[210] Regulation (EU) No 1215/2012 Recital 6.
[211] European Commission, Insolvency Proceedings, <http://ec.europa.eu/justice/civil/commercial/insolvency/index_en.htm>.
[212] Ibid.

Regulation (EU) 2015/848 introduced consolidation of insolvency law whilst Regulation (EU) 2017/1132 dealt with company law more broadly. To better inform this discussion and highlight the clear variations within the EU, several examples of the definitions of 'insolvent' have been taken from the Member States of Germany, Italy and France. A brief view of the processes and distribution priorities is also presented, highlighting the plight of the consumer with a warranty, express or implied.

3.9.1.1 Germany

German insolvency law was initially vested in the Bankruptcy Code of 1877 but superseded by the Insolvency Code in 1999. This code is subject to the Regulations imposed by the EU. If a debtor (individual or company) finds themselves heading towards insolvency, or 'illiquidity', they can file for a preliminary insolvency hearing.

> Final insolvency proceedings will be opened if the Court finds that (i) the debtor is illiquid, i.e. unable to pay its debts when they fall due (Zahlungsunfähigkeit), or (ii) the debtor is over-indebted, in the event that the debtor is a legal person or a legal entity which does not have at least one natural person who is personally liable without limitation, i.e. if the debtor's assets do not cover its liabilities (Überschuldung).[213]

Either a debtor or creditor can initiate insolvency proceedings. Whilst early negotiations with the complaining creditor can be ordered, that is usually only a temporary arrangement and a subsequent default will continue proceedings.[214] A final insolvency proceeding will commence if the court finds there is a ground for illiquidity and that there will be sufficient assets to at least cover the costs of proceedings. Whilst an administrator is appointed to oversee the assets of the debtor, and arrange meetings of creditors, secured creditors do have the right to claim their security.[215]

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[213] Mayer Brown, 'German Insolvency Law – an overview' (2017) <https://m.mayerbrown.com/files/...bf54.../German_Insovency_Oct_14_A4.pdf>.
[214] Ibid 4.
[215] Ibid 6.

> Secured creditors may, depending on the nature of their security right, have a direct claim against the insolvency estate for surrender of collateral or payment of the proceeds resulting from the realization of a security by the administrator (after deduction of certain fees). To the extent the security was not sufficient to cover the total amount of the secured claim, the remaining claim will in principle be treated as an unsecured insolvency claim.

Unsecured creditors must file their claims, "for registration with the insolvency claims schedule in order to receive (partial) payment, if any".[216] The administrator may reject claims. The final pool (if any) of money available to unsecured creditors is proportionate to "in essence the proceeds from the liquidation of all assets after deduction of all preferential claims, all security interests to the extent paid off or settled and the cost of the proceedings including court fees and the administrator's fees, to the total amount of accepted and unsecured insolvency claims".[217]

> If, after a successful recovery, the administrator can repay the company's debts, the company will be released from administration. However, in the overwhelming majority of cases creditors receive only partial satisfaction, if any. The debtor is then either deleted from the Commercial Register or released from the insolvency proceeding, stripped of all assets.[218]

It would appear that unsecured creditors are unlikely to receive any return.

3.9.1.2 Italy

Italian Insolvency Law is enshrined in the Royal Decree No. 267 of 16 March 1942 (the "Insolvency Code") that deals with insolvency of companies, and individuals who are deemed to be traders. It defines insolvency simply as: "…a debtor trader is insolvent when he is no longer able to regularly meet his obligations".[219] There is currently an in-depth reform of the legal framework of the insolvency regime being proposed in Italy, which, *inter alia*, will develop a clear definition of insolvency and introduce measureable tests "tailored on

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[216] Ibid 7.
[217] Ibid 7.
[218] Ibid 9.
[219] P.G. Monateri, 'Italian Insolvency Law' *The Cardozo Electronic Law Bulletin* <http://www.jus.unitn.it/cardozo/review/business/insol.html>.

specific industry standards".[220] Instigation of the bankruptcy proceedings may be made by any one of the debtor, a creditor, a Public Administrator or the Bankruptcy court.[221] The court appoints a receiver to identify and dispose of all the debtor's assets, review creditor claims, both secured and unsecured, submit a schedule of debt to the court, as well as report to creditors.[222] Payments are made to creditors based on a priority encoded in the Italian Civil Code and the Insolvency Code. "Creditors who believe their claims to be secured by mortgages, liens or other privileges must advise the receiver accordingly and if approved will be paid first". "The order of the distribution of assets as regards general claims is as follows:

1. The costs of bankruptcy proceedings, which have priority even over secured claims such as mortgages and pledges;
2. Employment compensation, including, without limitation, termination benefits;
3. Claims of independent professional contractors who performed services for the bankrupt during the twelve month period prior to the bankruptcy order; commissions due within the previous twelve months pursuant to agency agreements; and compensation for the termination of an agency.
4. Taxes on real property;
5. Claims of farmers;
6. Claims of suppliers of production plants and equipment, and the claims of banks which financed the purchase thereof;
7. The debtor's expenses for food, clothing, lodgings, medical treatment or funeral arrangements, incurred within a period of six months prior to the bankruptcy order, as well as the expenses relating to the support of the debtor's family within the previous three months.
8. Income taxes (subject to certain limitations);
9. Local taxes, social security payments and insurance premiums.

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[220] Paolo Manganelli, 'The proposed in-depth reform of Italian insolvency and enforcement procedures ' (2017) *Finance Update* <https://www.ashurst.com/en/news-and-insights/legal-updates/the-proposed-in-depth-reform-of-italian-insolvency-and-enforcement-procedures/>.
[221] Monateri, above n 193.
[222] Ibid.

Again, there seems to be little satisfaction for a consumer with a pending warranty claim; however, as with the general flavour of the EU Regulations, allowing the debtor to reorganise and continue trading will be a major component of the reform proposals.[223] This is a positive move for a holder of a longer-term warranty.

3.9.1.3 France

Under the French Commercial Code a debtor could be seen to be in difficulty if they have, or could be near to, a 'payment failure situation'. As defined in article L.631-1 "a debtor company is in a payment failure situation if it finds itself unable to meet its current liabilities out of its disposable assets". This definition can be closely scrutinised in two ways: from the point of view of the debtor or the creditor.[224] One analyst suggests that "French insolvency laws continue to be seen as debtor oriented and value destructive".[225] There is argument to suggest that where a debtor has obtained a moratorium from a creditor with regards to a debt, that debt could not be considered a current liability.[226] French law also contends that where money is owed to the debtor, as a creditor itself (unpaid rent for example), that money is not considered an asset of the debtor. "In this very classic situation, a popular French expression consists (*sic*) in saying that the debtor company "*has money on the outside*.""[227] Furthermore:

> This explains why, in French law, a payment failure situation is not the same as insolvency: the two concepts are distinct. A person is insolvent when his total liabilities are greater than his total assets. In such a case, the person has no chance of being able to honour all of his debts. On the other hand, a person is not going to avoid a payment failure situation by showing that his accumulated assets are theoretically sufficient to pay the sum total of his

[223] Manganelli, above n 194.
[224] Andrew Tetley and Marcel Bayle, 'Insolvency Law in France' (2009) *Reed Smith* <https://www.reedsmith.com/-/media/files/perspectives/2009/06/insolvency-law-in-france/files/insolvency-law-in-france/fileattachment/franceaspublished.pdf>, 202.
[225] Bruno Basuyaux and Emilie Haroche, 'The 2014 French Insolvency Law reform: a missed opportunity?' (2015) 30(2) (February) *Butterworths Journal of International Banking and Financial Law* 115.
[226] Tetley and Bayle, above n 198, 203.
[227] Ibid 205.

debts, where in practical terms he is unable to pay his creditors because he has “money on the outside”.

These two concepts are similar to those discussed at 3.6.3 in the Australian scenario, with the payment failure situation being equivalent to the Australian insolvency definition.

In France, a debtor or creditor may petition the court to commence proceedings with regards to a payment failure situation. Generally, the courts take the positive approach of considering whether the debtor can reorganise with the view to continuing to trade. Once it can be determined that the situation of the debtor is irreversible, liquidation proceedings commence. A liquidator is then appointed, creditors must lodge claims, and assets collected.[228]

In all liquidation proceedings, the liquidator draws up the “order of creditors”. The order of priority is as follows:

- employee wage claims guaranteed by the super priority accorded to employees;
- legal costs properly incurred after the commencement order where required for the conduct of the proceedings, which includes remuneration due to the court appointees (creditors’ representative, liquidator, etc);
- priority for “new money”;
- claims which, although arising before the commencement order, are guaranteed by security over real property or over particular personal property accompanied by a right to retain possession, as well as claims guaranteed by general security over the business and security over professional tooling and equipment;
- wage claims of employees arising after the commencement order, which have not been advanced by the wages guarantee fund;
- claims arising from current contracts, where the party that has contracted with the company in difficulty has agreed to defer receipt of payment for its services;
- amounts advanced by the wages guarantee fund;
- claims arising after the commencement order, according to their ranking in the Civil Code;

[228] Ibid 226-255.

- claims arising prior to the commencement order and secured by general liens;
- claims arising before the commencement order, according to their ranking in the Civil Code; and
- unsecured creditors.

It is assumed here that a consumer with a warranty and no current claim would be at best classed as an unsecured creditor.

3.9.1.4 EU Regulations

The most detailed report requested by the European Commission was titled 'Study on a new approach to business failure and insolvency: Comparative legal analysis of the Member States' relevant provisions and practices'[229], co-authored by Professor Andrew Keay, a well-known author on the subject of bankruptcy and insolvency.[230] He and a team from the University of Leeds were charged with four specific tasks:[231]

- The collection of data about reforms in the EU Member States that implement the Commission Recommendation 2014/135/EU, issued on 12th March 2014 on a new approach to business failure and insolvency.
- Collect data in order to enhance the comparative law information at the disposal of the Commission in respect of matters such as the regulation, status and powers of Insolvency Practitioners; the duties and liabilities of directors and the recognition of disqualifications, rules on the ranking of claims/order of priorities and the conditions under which certain detrimental acts can be avoided; conditions for opening insolvency proceedings and fast-track or standardised procedures for small and medium sized enterprises (SMEs).
- The collection of data about the procedures available to over-indebted Consumers explaining how over-indebtedness is dealt with in the Member States including the conditions and timeframe for debt reduction and discharge.

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[229] Gerard McCormack et al, 'Study on a new approach to business failure and insolvency: Comparative legal analysis of the Member States' relevant provisions and practices' (University of Leeds, January 2016) <http://ec.europa.eu/justice/civil/files/insolvency/insolvency_study_2016_final_en.pdf>.
[230] Murray and Harris, above n 117; *Keay's Insolvency: Personal and Corporate Law and Practice* (Lawbook Company, 7th ed, 2011) is just one example.
[231] McCormack, above n 203, 21.

- To carry out a horizontal cross-cutting analysis of the data; identifying areas where disparities in national laws produce problems that have impacts outside national boundaries

The report also used two comparator countries, Norway and USA. These countries were selected based on their ranking in a World Bank 'Doing Business' project.[232]

Several points of interest with regards to the consumer warranty holder have arisen from that report. Firstly, the EU recognised that, as a consequence of encouraging the development of the 'internal market', there would be a significant growth of cross-border trading, and subsequently cross-border insolvency. [233] The Commission Recommendation and subsequent Regulation[234] introduced several initiatives to firstly attempt to keep the debtor from entering into liquidation[235] and thereby increase the recovery rates for creditors.[236] Secondly, the EU acknowledged that the debtor may have assets in various States and has implemented over-arching procedures to ensure that as many assets as possible are encompassed in any insolvency procedure, for the benefit of the creditors.[237] Furthermore, to allow greater communication between the States and the courts of the States, there is a requirement to establish an Insolvency register in each Member State[238] with a commitment by the European Commission to interconnect these registers from 26 June 2019.[239] A benefit for the consumer is that there will be greater transparency with regards to which suppliers may be in financial trouble, allowing them to either avoid dealing with them in the first place, or second, if applicable, lodge a creditor claim for breach of warranty within the necessary timeframes.

The other relevant point of interest from the report by a team from the University of Leeds is the chapter on 'ranking of claims and order of

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[232] World Bank, *Resolving Insolvency* (June 2016) <http://www.doingbusiness.org/data/exploretopics/resolving-insolvency>.
[233] Regulation (EU) 2015/848 Recital 3-5, Commission Recommendation 2014/135/EU Recital 7.
[234] Ibid.
[235] Commission Recommendation 2014/135/EU (2)(c).
[236] Commission Recommendation 2014/135/EU (2)(b).
[237] Regulation (EU) 2015/848 Chapters II and III.
[238] Regulation (EU) 2015/848 Article 24.
[239] Regulation (EU) 2015/848 Article 25.

priorities'.[240] "This study has indeed revealed very different approaches in Member States on the priorities enjoyed by the holders of security interests (secured creditors) and preferential (priority) claimants in an insolvency".[241] As a general rule, they found that secured creditors were always paid before unsecured creditors[242], with some Member States retaining some portion of the realised assets for the benefit of unsecured creditors, to the detriment of secured creditors, as the latter may not receive their full claim under this process.[243]

The authors note that secured creditors are generally paid first as they have bargained for property rights in respect of the debtors' assets, which ultimately respects the right to freedom of contract. They also state:

> On the other hand, there may be involuntary creditors ….. These creditors in a weak bargaining position are perhaps most likely to be the ones that will be hit hardest by the debtor's insolvency. The insolvency may impact disproportionately on them in that they are not very capable of sharing or passing on the costs of the loss. Large financial institutions which are most likely to take security are in a much better position to pass on losses.[244]

Consumers with a warranty would be classified as 'involuntary'[245], or unsecured creditors, with little prospect of being able to claim should a breach of warranty arise subsequent to the liquidation of a company in any Member State of the EU.

3.10 Summary - Insolvency

[240] McCormack, above n 203, 112.
[241] Ibid.
[242] Ibid 119.
[243] Ibid 119.
[244] Ibid 121.
[245] The term 'involuntary creditors' has been used by a number of academic writers; Lynn M LoPucki, 'The Unsecured Creditor's Bargain' (1994) 80(8) *Virginia Law Review* 1887; David Kershaw, 'Involuntary Creditors and the Case for Accounting-Based Distribution Regulation' (Working Paper No 16/2007, London School of Economics and Political Science Law Department); Hanoch Dagan, 'Restitution in Bankruptcy: Why all Involuntary Creditors Should Be Preferred' (2004) 78(3) *American Bankruptcy Law Journal* 247; Stephanie Ben-Ishai & Stephen J Lubben, 'Involuntary Creditors and Corporate Bankruptcy' (2012) 45(2) *UBC L Rev* 253.

The consideration of this major section has been whether a consumer with active entitlements, and specifically an unexpired warranty, has an opportunity to make a claim should the need arise, after the warranty provider ceases to trade.

The basis upon which a company, or sole trader, may enter into legal proceedings to wind up the business generally varies in respect of some technicalities between the jurisdictions of Australia, USA and the EU. There are very positive processes available in all jurisdictions to encourage both the debtor and their creditors to consider the possibility of working through the financial difficulties experienced by the debtor, with a view to allowing the debtor to continue to trade. This outcome would be most welcome to active entitlement holders.

Ultimately, the winding up or liquidation process in each of the jurisdictions determined that unsecured creditors, were usually the last on the list to receive any dividend from that process. The consumers within that group had no opportunity to consider whether there may have been any risk contracting with the defaulting company and should therefore be treated differently.

Given that scenario, alternatives must be considered to preserve the value that has been paid by the consumer for the active entitlement, both implicitly and expressly. Certainly in Australia there is still a lack of clarity as to whether a warranty holder would have the opportunity to even make a claim, and if so, it would likely be for a very small amount, or even zero, due to the uncertainty of any future event.

The issue of consumer detriment at the time of company insolvency has been a point of concern in a number of industries and has been addressed in an ad hoc fashion through legislative intervention over the last century. The next chapter reviews these ad hoc measures in Australia, United States of America and the European Union to understand the detriment caused as well as the reasoning behind the measures implemented.

FOUR

WHAT MEASURES ARE CURRENTLY BEING EMPLOYED TO COMPENSATE CONSUMERS?

4.1 Introduction

Chapter Three has provided the background of current regulatory policy that protects consumers when they purchase goods and services. Furthermore, when a company ceases to trade, the insolvency framework provides little specific protection for consumers and indeed it is recognised that the insolvency framework was not developed with consumers in mind. This chapter highlights a gap in the regulatory framework that provides no protection for consumers with active entitlements when a company ceases to trade. The impact that insolvency of companies has had on certain marketplaces has given rise to some ad hoc regulatory measures. As stated just prior to 3.1.2.2. the use of the six-step approach to consumer policy issues[1] should be considered during this analysis. Steps one to three had been fulfilled at that point. In this chapter, step four will be considered as it analyses the regulatory options that were implemented in various industries where consumers held active entitlements when a company had ceased to trade. Those industries have reacted by providing compensatory measures to ensure the consumer detriment is mitigated. These measures have variously and individually been implemented in Australia, the USA and the European Union. This chapter will firstly examine the regulatory gap, and then analyse the environments in which the regulatory measures have been implemented.

4.2 Defining the Regulatory Gap

[1] Policy and Research Advisory Committee of the Standing Committee of Officials of Consumer Affairs, 'Consumer policy in Australia: A companion to the OECD Consumer Policy Toolkit' (March 2011) <https://consumerlaw.gov.au/sites/consumer/files/2015/09/Companion_to_OECD_Toolkit.pdf >..

The current Australian Consumer Law provides clear guarantees to the consumer with regards to their relationship with either the manufacturer or the supplier (which may be a different entity), when a consumer purchase is made.[2] Many of such guarantees relate to responsibilities that must be borne by the manufacturer and to a lesser extent by the direct supplier. Additionally, during that transaction the consumer can accumulate a number of active entitlements including the benefit of a deposit paid, the use of unexpired gift cards, or the benefit of a product warranty, either express from the manufacturer or implicit from the ACL guarantees.

Guarantees provided by Australian Consumer Law, include for example s54[3], which provides for a guarantee as to the acceptable quality of the goods purchased. The period of time, from purchase, within which a consumer may find goods not of acceptable quality, is called the 'rejection period'.[4] This period is the time in which it would be reasonable to expect a failure to become apparent "having regard to: (a) the type of goods; and (b) the use to which a consumer is likely to put them; and (c) the length of time for which it is reasonable for them to be used; and (d) the amount of use to which it is reasonable for them to be put before such a failure occurs". Furthermore, there is a time limit for action under s273:[5]

> An affected person may commence an action for damages under this Division at any time within 3 years after the day on which the affected person first became aware, or ought reasonably to have become aware, that the guarantee to which the action relates has not been complied with.

All guarantees provided by the ACL are subject to the rejection period and the time limit for action. Whilst the rejection period is variable, the time for action is fixed at three years, creating a significant window of time in which a company may cease to trade. Additionally, express guarantees provided by the manufacturer may potentially extend past the time in which the 'rejection period' is enforced, thus creating an even wider window.

All of the benefits from those ACL guarantees, and express guarantees, cease to exist once the manufacturer ceases to trade. Furthermore, the

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[2] *Competition and Consumer Act 2010* (Cth) Schedule 2 s51-62.
[3] *Competition and Consumer Act 2010* (Cth) Schedule 2.
[4] *Competition and Consumer Act 2010* (Cth) Schedule 2 s262(2).
[5] *Competition and Consumer Act 2010* (Cth) Schedule 2.

benefits of the active entitlements cease to be benefits to the consumer. The only relief that a consumer currently may have is to be on a list of unsecured creditors through the insolvency process (see 3.6.3.4). The consumer regresses, from an entity with many benefits, to one with usually zero benefits, when a company fails. That is a huge gap in regulation for the consumer.

The regulatory theories discussed in Chapter Two were postulated to firstly describe similar phenomena or events.[6] Having grouped like events, it was then possible to predict what may happen when a similar event was to occur. In making a prediction about how a regulatory measure, to be enacted, may operate, an assumption is made that the regulatees would comply with the regulation. However, that does not always happen. The lengthy history of regulation in the Stock Exchange industry, and others, will attest to the fact that a variety of regulatory measures were undertaken, through self-regulation and later government legislation. The overt reason was that the legislation was to counter an actuarial risk, whereby an external event may cause harm to an individual, collective or the environment.[7] That external risk was the insolvency of players within the industries described and the potential harm caused to consumers participating in transactions within those industries. That is the same risk this thesis is primarily concerned about and relates to consumers holding active entitlements in any industry. It should also be noted that within the various solutions described below, the focus has been on protecting the individual consumer and not other business entities that may also be in the same predicament.

Some classes or groups of consumers are currently protected by regulatory mechanisms that could be adapted for the benefit of all consumers. The following sections describe the legislative arrangements of the existing models, so that a solution to close the regulatory gap for all consumers with active entitlements can then be developed.

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[6] John G Wacker, 'A definition of theory: research guidelines for different theory-building research methods in operations management' (1998) 16 *Journal of Operations Management* 361, 367.

[7] Fiona Haines, 'Regulation and risk' in Peter Drahos (ed), *Regulatory Theory: Foundations and applications* (ANU Press, 2017).

4.3 Stock Exchange Compensation Schemes

4.3.1 Background

The World Federation of Exchanges produced a research publication in conjunction with the United Nations Conference on Trade and Development (UNCTAD) [8] analysing how stock exchanges might promote economic development within countries. The report suggests "the growth of small and medium enterprises (SMEs) is an important element in the overall development of an economy and the creation of jobs".[9] Today, "a stock exchange is an organised marketplace, licensed by a relevant regulatory body, where ownership stakes (shares) in companies are listed and traded".
Ownership stakes were traded long before regulation. History shows that where there were people with more money than others, lending by the wealthy to the poor constituted the early trading ventures, with lenders sometimes trading high-risk debts for others.[10] "In the 1300s, the Venetians were the leaders in the field and the first to start trading the securities from other governments. They would carry slates with information on the various issues for sale and meet with clients, much like a broker does today". A stock exchange was established in Belgium in 1531 where brokers and moneylenders would meet "to deal with business, government and even individual debt issues".[11] A short time later in 1553 a joint-stock company, the Muscovy Company, first issued shares in its trading company dealing with Russia. The selling of shares became a significant method of raising money for trips to the east by companies such as the Dutch United East India Company in the 1600s.[12] Indeed, "in the 1600s, the Dutch, British, and French governments all gave charters to companies with East India in their names" offering the ship owners the opportunity to hedge their risks.

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[8] Siobhan Cleary et al, 'The Role of Stock Exchanges in Fostering Economic Growth and Sustainable Development' (World Federation of Exchanges, 2017) <https://www.world-exchanges.org/home/index.php/files/18/Studies---Reports/473/WFE-UNCTAD-Exchanges---Growth-and-Sustainable-Development.pdf>.
[9] Ibid.
[10] Andrew Beattie, *The Birth of Stock Exchanges* (24 April 2017) Investopedia <https://www.investopedia.com/articles/07/stock-exchange-history.asp>.
[11] Ranald Michie, *The London Stock Exchange: A History* (Oxford University Press, 2001)..
[12] Ibid.

> To lessen the risk of a lost ship ruining their fortunes, ship owners had long been in the practice of seeking investors who would put up money for the voyage - outfitting the ship and crew in return for a percentage of the proceeds if the voyage was successful. These early limited liability companies often lasted for only a single voyage. They were then dissolved, and a new one was created for the next voyage. Investors spread their risk by investing in several different ventures at the same time, thereby playing the odds against all of them ending in disaster.
>
> When the East India companies formed, they changed the way business was done. These companies had stocks that would pay dividends on all the proceeds from all the voyages the companies undertook, rather than going voyage by voyage. These were the first modern joint stock companies. This allowed the companies to demand more for their shares and build larger fleets. The size of the companies, combined with royal charters forbidding competition, meant huge profits for investors.[13]

In the 1700s in England the British East India Company took great advantage of its unique government-backed monopoly, and as the investors received huge dividends, there were many 'businessmen' who entered the market. These 'businessmen' rushed in to offer shares in ventures that quite often became scams. As the financial 'boom' in England continued there were no rules or regulations regarding the issuing of shares. The South Seas Company was one of many that promised large and delivered small and ultimately there was a 'crash' in the market which led the British government to outlaw the issuing of shares, a ban which lasted until 1825.[14]

During the boom times there were many new brokers involved in day-to-day trading and "in 1760, after being kicked out of the Royal Exchange because of their rowdiness, a group of 150 brokers formed a club at Jonathan's Coffee House where they met to buy and sell shares and government bonds".[15] According to Thorbury:[16]

> The following is from an old paper, dated July 15th, 1773: "Yesterday the brokers and others at 'New Jonathan's' came to a resolution, that instead of its being called 'New Jonathan's,' it should be called 'The Stock Exchange,'

[13] Beattie, above n 8.
[14] Beattie, above n 8.
[15] Ranald Michie, above n 11.
[16] Walter Thorbury, 'The Stock Exchange' in *Old and New London* (Cassell, Petter & Galpin, 1878) vol 1, 473.

> which is to be wrote over the door. The brokers then collected sixpence each, and christened the House with punch."

After outgrowing this location the brokers pooled their money and constructed a building nearby which was then known as The Stock Exchange. In 1801 it became a regulated exchange.

In the early days of settlement in the USA, in 1653 in New York State, a twelve-foot high stockade or wall was built across lower Manhattan, from river to river, to protect Dutch settlers from being attacked by the British or by Native Americans. In 1685 surveyors laid out a new road along the edge of the stockade and called it Wall Street. One hundred years later a group of prominent brokers were gathering in Wall Street under a Buttonwood tree and agreeing to terms of trade on a commission basis.[17] "The agreement was an attempt to establish some rules after the 1792 financial panic, when there had been no rules or safeguards, and a lot of deals were reneged on. Subsequently, in 1817 the first constitution of the regulated exchange was drafted.[18]

Another important legal issue was brewing around the same time:[19]

> In America, the first limited liability law for manufacturing companies came into force in the state of New York in 1811. The flight of capital from states without this law led most other US states to follow suit, with Britain - at the time the world's foremost economic power - promulgating a limited liability law in 1854.
>
> Before the promulgation of these laws, limited liability shareholders risked going bankrupt or ending up in debtors' prison if their companies did. Understandingly, few people would buy shares in a firm unless they knew its managers well or could monitor their activities, especially their borrowings. But the new law allowed passive investors to risk their capital with entrepreneurs, unlocking vast sums for investment in the rapidly growing

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[17] Olivia B Waxman, 'How a Financial Panic Helped Launch the New York Stock Exchange' (2017) (May 17) *Time* <http://time.com/4777959/buttonwood-agreement-stock-exchange/>;

> We the Subscribers, Brokers for the Purchase and Sale of Public Stock, do hereby solemnly promise and pledge ourselves to each other, that we will not buy or sell from this day for any person whatsoever, any kind of Public Stock, at a less rate than one quarter per cent Commission on the Specie value and that we will give a preference to each other in our Negotiations. In Testimony whereof we have set our hands this 17th day of May at New York. 1792.

[18] Andreas M Fleckner and Klaus J Hopt, 'Stock Exchange Law: Concept, History, Challenges' (2013) 7 *Virginia Law & Business Review* 514.

[19] Ranald Michie, above n 10.

> number of factories and also freed companies from the burden of fixed-interest debt.
>
> The rapid rise of share-holding and limited liability companies is evident from the fact that, in 1860, British government bonds made up half of the total of the market capitalization of securities in London but that, by 1914, it had decreased to less than 5%. The explosion of trading in railroad, steel and chemical shares helped New York overtake London as the world's leading financial centre.

The conditions under which a person became a member the Stock Exchange in England prior to regulation were quite strict. Again, as Thorbury explains:[20]

> The election of members is always by ballot, and every applicant must be recommended by three persons, who have been members of the house for at least two years. Each recommender must engage to pay the sum of £500 to the candidate's creditors in case any such candidate should become a defaulter, either in the Stock Exchange or the Foreign Stock market, within two years from the date of his admission. ….. No applicant who has been a bankrupt is eligible until two years after he has obtained his certificate, or fulfilled the conditions of his deed of composition, or unless he has paid 6s. 8d. in the pound. No one who has been twice bankrupt is eligible unless on the same very improbable condition.

The security 'bond' that was required to be held by each recommender could be seen as the first version of a 'fidelity fund'. Brokers only succeeded through their honesty and were held to be of the highest integrity.[21]

> It is said that a member of the Stock Exchange who fails and gives up his last farthing to his creditors is never thought as well of as the man who takes care to keep a reserve, in order to step back again into business. For instance, a stockbroker once lost on one account £10,000, and paid the whole without a murmur. Being, however, what is called on the Stock Exchange "a little man," he never again recovered his credit, it being suspected that his back was irretrievably broken.

[20] Thorbury, above n 14.
[21] Thorbury, above n 14.

If the unfortunate situation occurred that a broker defaulted, it appeared that the other stockbrokers took the loss themselves.[22]

> When a defalcation takes place in the Stock Exchange (says a City writer of 1845), the course pursued is as follows:—At the commencement of the "settling day," should a broker or jobber—the one through the default of his principals, and the other in consequence of unsuccessful speculations—find a heavy balance on the wrong side of his accounts, which he is unfortunately unable to settle, and should an attempt to get the assistance from friends prove unavailing, he must fail. Excluded from the house, the scene of his past labours and speculations, he dispatches a short but unimportant communication to the committee of the Stock Exchange. The other members of the institution being all assembled in the market, busied in arranging and settling their accounts, some of them, interested parties, become nervous and fidgety at the non-appearance of Mr.—(the defaulter in question). The doubt is soon explained, for the porter stationed at the door suddenly gives three loud and distinctly repeated knocks with a mallet, and announces that Mr.—presents his respects to the house, and regrets to state that he is unable to comply with his "bargains"—*Anglicè*, to fulfil his engagements.

Ultimately, as described by the CEO of the World Federation of Exchanges, stock exchanges are a very important institution as:[23]

> Well-functioning exchanges enable economic growth and development by facilitating the mobilisation of financial resources - by bringing together those who need capital to innovate and grow, with those who have resources to invest.

4.3.2 Australia

The first corporate venture after the colonisation of Australia in 1788 came in 1817 with the founding of The Bank of New South Wales. The gold rush in Victoria in the 1850s saw the creation of stock exchanges in Melbourne, Ballarat and Bendigo.[24] In 1861, a group of brokers joined together and published rules for admission to the Stock Exchange of Melbourne. The

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[22] Thorbury, above n 14.
[23] Cleary, above n 7.
[24] ASX, *History* ASX <http://www.asx.com.au/about/history.htm>.

Sydney Stock Exchange was formed in 1871, the Hobart Stock Exchange in 1882, the Brisbane Stock Exchange in 1884, the Stock Exchange of Adelaide in 1887, and the Stock Exchange of Perth was opened in 1889.[25]

> After three large failures of Stock Exchange members, the New South Wales Legislative Assembly in December 1936 pressed the then Premier to investigate the establishment of a government-supervised fund to reimburse clients of failed brokers.
>
> However, the then Chairman of the Sydney Stock Exchange, Mr E.G. Blackmore grasped the public sentiment and determined that the Exchange must establish its own guarantee fund without delay thereby maintaining the right to regulate itself. Members expressed their approval of the guarantee fund at a general meeting in May 1937.[26]

Similarly in Melbourne[27],

> Following the unexpected collapse of a broking firm in June 1937, the then Chairman of the Melbourne Stock Exchange seriously considered setting up a fidelity fund. There was also pressure on the Victorian Government to introduce legislation that would require the stock exchange to establish a fidelity fund. Eventually the Melbourne Stock Exchange and the Victorian Government rejected the need for a fidelity fund and addressed the issue by introducing accounting reforms which required brokers to set up client trust accounts that were overseen by government regulators.

The Perth Stock Exchange established its fidelity fund in 1968 during the nickel boom. In his book about the Brisbane Stock Exchange, historian A. Lougheed noted that in 1971[28],

> The Committee of the Exchange established a Fidelity Fund which could be resorted to in the event of a client of a member of the Exchange suffering a loss through bankruptcy or misappropriation by a member of the Exchange. By the end of 1982-83 the total assets of the Fund had risen to $525,044. It is to the great satisfaction and pride of the Exchange that no client has suffered in this way in the history of the Exchange.

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[25] Ibid.
[26] Department of the Treasury, 'Attachment C: The Origins of the National Guarantee Fund' in Department of the Treasury (ed), *Review of Compensation for Loss in the Financial Services Sector* (2002) .
[27] Ibid.
[28] A L Lougheed, *The History of the Brisbane Stock Exchange 1884-1984* (Boolarong Publications, 1984), 166.

Eventually, self-regulation by the exchanges was superseded as legislation made its way into the life of the stock exchanges in Australia when:

> The Melbourne Stock Exchange established its fidelity fund after the Victorian Government introduced the Securities Industries Act in 1970 which required the stock exchange to establish a fidelity fund to compensate for losses from any defalcation committed by an Exchange member or his employee.

At the time the *Securities Industry Bill 1970* (NSW) was introduced to the NSW Parliament, there was no other legislation in place apart from the rules maintained by the Sydney Stock Exchange itself. At the commencement of the second reading the Assistant Minister to the Attorney-General stated:[29]

> The major object of the Securities Industry Bill is to ensure that there is adequate protection for the public in the field of stock market investment. To attain this object the bill sets up a corporate affairs commission, makes the establishment of stock markets subject to ministerial approval, subjects the rules of stock exchanges to scrutiny, provides for licensing and the keeping of proper books and trust accounts of those engaged in the securities industry and the setting up of stock exchange fidelity funds, and creates new offences with respect to trading in securities.

New elements introduced, over and above those of trust accounts, were licenses for brokers and the setting up of a fidelity fund. The Assistant Minister elaborated[30]:

> Part IV deals with the licensing of those persons who are engaged in the securities industry. The purpose of these provisions is to ensure that they are fit and proper persons, and that some guarantee against financial default of dealers is available.

With regards to the fidelity fund, and in a similar fashion to the legal profession[31], "a stockbroker must deposit with his stock exchange one-third of the lowest balance of his trust account. The exchange invests these deposits in interest-bearing accounts and pays the income to the fidelity fund set up under part VII of the bill".[32] Brokers were also compelled to make annual contributions to the fund. Furthermore,

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[29] New South Wales, Parliamentary Debates, Legislative Assembly, 17 March 1970, 4362-4393 (Mr Freudenstein, Assistant Minister, on behalf of the Attorney-General).
[30] Ibid 4364.
[31] For example s46 *Legal Profession Uniform Law Application Act 2014* [NSW].
[32] New South Wales Parliamentary Debates, above n 27, 4366.

> When the fund reaches the figure of $2,000,000, every broker who has made twenty annual contributions is exempt from making further annual contributions and, on his retirement or death the exchange committee may, at its discretion, repay all or part of his annual contributions with or without interest. On the other hand, if the fund is reduced below $1,000,000, a broker who has been exempt shall again be required to pay contributions. Clause *55* enables the committee to impose levies if the fund is at any time insufficient to satisfy its liabilities, such levies not exceeding $5,000 in the aggregate, or $1,000 in any one year.

The licensing of stockbrokers brought with it the test of "fit and proper", which was also the test for a person entering the legal profession. The test "refers to a person's past record which can be proven as a fact"[33] Clearly the legislators expected that a person passing this test would not default on their financial obligations. "The fit and proper test was carried forward in ss 37 (for dealers and investment advisers) and 38 (representatives) of the uniform *Securities Industry Acts* of the four ICAC States in 1975".

Indeed, the same legislation was passed by all Australian state parliaments within a year, ensuring that all stock exchanges operated under the same regulations and compensation regime.

A short time later:[34]

> The States that were parties to the Interstate Corporate Affairs Agreement enacted the *Securities Industry Act 1975* (the 1975 Act), which required each stock exchange to establish a fidelity fund. In the case of exchanges that did not have a fund established under the 1970 Act, an amount of $100,000 was required.
>
> The 1975 Act required that:
>
> - a person could only be admitted as a member of a stock exchange if he had made a contribution to the fidelity fund of the stock exchange of not less than $500;
> - the fidelity fund of a stock exchange be applied to compensate persons who suffered pecuniary loss by reason of a defalcation, or fraudulent misuse of money, securities or of other property by a member of the exchange (or its employees) where that property had

[33] Paul Latimer, 'Providing financial services "efficiently, honestly and fairly"' (2006) 24 *Company and Securities Law Journal* 362, 364.
[34] Department of the Treasury, above n 24.

been received in connection with the firm's business of dealing in securities.

The Act also provided that the stock exchange could impose a levy on each contributor if the fidelity fund became insufficient.

Subsequently the *Securities Industry Act 1980* (Cth) came into force as part of that Commonwealth/State agreement and whilst licensing requirements and attributes of the fidelity fund may have been fine-tuned, there were no other significant regulatory initiatives that were to protect the investing consumer. There were, however, significant legislative changes with respect to the financial services industry and companies in general, with the introduction of the *Financial Services Reform Act 2001* (Cth) and the *Corporations Act 2001* (Cth). The National Companies and Securities Commission was replaced by the Australian Securities Commission in 1991, which was renamed the Australian Securities and Investments Commission (ASIC) in 1998, and now operates with powers provided by the *Australian Securities and Investments Commission Act 2001* (Cth).

Regulation of the financial services and markets in Australia is now contained in Chapter 7 *Corporations Act 2001* (Cth), with s760A stating:

> The main object of this Chapter is to promote:
>
> (a) confident and informed decision making by consumers of financial products and services while facilitating efficiency, flexibility and innovation in the provision of those products and services; and
>
> (b) fairness, honesty and professionalism by those who provide financial services; and
>
> (c) fair, orderly and transparent markets for financial products; and
>
> (d) the reduction of systemic risk and the provision of fair and effective services by clearing and settlement facilities.

The various stock exchanges had met on a regular basis from the early 1900s and in 1936 The Australian Associated Stock Exchanges was formed. This entity, over the following years, developed and implemented "common listing requirements for companies and uniform brokerage and other rules for stockbroking firms".[35] Then in 1987:

[35] ASX, above n 22.

> The Australian Stock Exchange Limited (ASX) was formed on 1 April 1987, through incorporation under legislation of the Australian Parliament. The formation of this national stock exchange involved the amalgamation of the six independent stock exchanges that had operated in the states' capital cities.

Included under the Australian Government legislation[36] was the formation of the National Guarantee Fund.

The 1987 Act provided legislative support:[37]

- for a reorganisation of the stock exchanges in Australia to establish a single national stock exchange; and
- to create a national guarantee fund consisting of a portion of the pooled assets of the existing fidelity funds operated by the separate capital city exchanges;
    - the remainder was used to acquire the assets of the state stock exchanges and to finance innovations including the move to screen trading.

The Hon Lionel Bowen MP, in the second reading speech on 18 February 1987, stated:[38]

> The 1986 Australian Share ownership survey conducted by the [Australian Associated Stock Exchanges] indicated that almost 90 per cent of adult Australians do not own shares. One of the major reasons given by those surveyed was that they preferred safer, less risky, investments. The contract guarantee and insolvency protection afforded by the National Guarantee Fund may serve to alleviate some of these concerns. The no-fault contract guarantees will ensure that where a party to a securities transaction does not complete his obligations, those obligations will be met by the National Guarantee Fund. This no fault system of contract guarantees contrasts with claims against existing fidelity funds under the provisions of Part IX of the *Securities Industry Act 1980* where defalcation or fraudulent misuse of property is required to establish a claim. Direct access to the National Guarantee Fund for compensation in respect of a dealer insolvency also contrasts with existing fidelity fund provisions which allow for compensation via formal Bankruptcy Act mechanisms.

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[36] *Australian Stock Exchange and National Guarantee Fund Act 1987* (Cth).
[37] Department of the Treasury, above n 24.
[38] Commonwealth, *Parliamentary Debates*, House of Representatives, 18 February 1987, 268 (Lionel Bowen).

Securities Exchanges Guarantee Corporation Limited (SEGC)[39] is a company limited by guarantee, which was incorporated in 1987 to be the trustee of the National Guarantee Fund (NGF). The sole member of SEGC is ASX Limited. SEGC publishes an annual report[40] each year, which includes details of claims made against the fund. The 2007 report indicated that in the first four years of operation there were a high number of claims, resulting from the insolvency of seven stockbrokers with a further insolvency in the years 1992-1993. They also reported that since 1993 the ASX had introduced significant improvements in settlement and transfer systems and up to 2007 only one other broker had become insolvent. Insignificant claims were made against the fund until 2010 and 2011 when they received many claims relating to the collapse of Opes Prime Stockbroking Ltd; however, due to the legal relationship between Opes and their clients, most claims were rejected and they did not meet the claims criteria of the SEGC.[41]

> Under this agreement, unencumbered title in securities and collateral passed from the original owner to Opes Prime on delivery[42]. The economic effect of these arrangements was similar to a standard margin lending facility, but the important legal difference was that with the Opes Prime facilities, clients transferred all legal and beneficial interest in securities and collateral to Opes Prime.

Subsequent years had seen very few claims until 2015 as a result of the collapse of financial services and stockbroking group BBY Ltd.[43] BBY was ultimately placed into liquidation on 22 June 2015.

> In the liquidators Annual Report for BBY published in September 2016, the liquidators indicated that their initial investigations indicate a shortfall in the BBY client segregated accounts (CSAs) of $23 million against potential claims totaling $61 million…… As at 20 September 2017 SEGC has paid BBY claims totaling $2,140,760.[44]

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[39] http://www.segc.com.au/.
[40] http://www.segc.com.au/annual_report.html.
[41] SEGC, *Annual Report 2011*, http://www.segc.com.au/annual_report.html.
[42] *Beconwood Securities Pty Limited and Anor v Australia and New Zealand Banking Group Limited and Ors* (2008) 246 ALR 361at paragraph 50.
[43] SEGC, *Annual Report 2015*, http://www.segc.com.au/annual_report.html.
[44] SEGC, *Annual Report 2017*, http://www.segc.com.au/annual_report.html.

The SEGC regularly, and at least annually, reviews the minimum amount of funds to be maintained in the NGF.[45] Section 889J *Corporations Act 2001* (Cth) provides the SEGC with powers to impose levies upon operators of financial markets if the NGF falls below the minimum amount.

Legislative intervention has begun to play a major role in the stock exchange marketplace in Australia, and although there have been relatively few stockbroker insolvencies, there has been a great deal of effort and money invested into ensure that the securities marketplace offers limited risk to consumers.

Investment by wealthy individuals in the exploits of others, for the potential to see a return on that investment, has been part of human culture for centuries. The eventual centralisation of the trading of those investments in a controlled manner has seen the development of the stock exchange and the associated development of economic societies. It is clear that stock exchanges provide a platform where resources can be redirected to those who need them, and at the same time stock exchanges are promoting better governance in business practices, which in turn benefits the economy.[46]

The decision by several stock exchanges to develop a fidelity fund could arguably be described as for their own benefit. At that stage the exchanges were running a business and a very limited number of the public were purchasing stocks. There was no decision made 'for the public good'. It was only when the government became involved that it could either be a public good decision to legislate the creation of fidelity funds, or the government of the day was lobbied by the elite, who were the main customers of the stock exchange.

Since the inception of the fidelity funds in Australia (now the NGF), there have been very few collapses by members of the stock exchange and valid claims have been paid.[47] It is unclear as to whether the measures to regulate the activities of stockbrokers, such as licencing and trust accounts, have reduced the collapses or whether there is a substantially higher level of corporate responsibility.

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[45] Ibid.
[46] Cleary, above n 7, 5.
[47] SEGC, above n 41.

4.3.3 USA

Following the formation of the New York Stock Exchange (NYSE) in 1792 a new constitution with rules for the conduct of trade were developed, and in 1817 the New York brokers established a formal organisation and rented rooms at 40 Wall Street, while in 1836 the rules prohibited trading in the street.[48] The regulation at that time, by the New York Stock & Exchange Board, was mostly administered internally and related to the listing of stocks. There was little support for US government regulation until public confidence in the markets plummeted when the stock market crashed in October 1929.[49]

> There was a consensus that for the economy to recover, the public's faith in the capital markets needed to be restored. Congress held hearings to identify the problems and search for solutions.
>
> Based on the findings in these hearings, Congress — during the peak year of the Depression — passed the Securities Act of 1933. This law, together with the Securities Exchange Act of 1934, which created the SEC, was designed to restore investor confidence in our capital markets by providing investors and the markets with more reliable information and clear rules of honest dealing.

These pieces of legislation were designed to increase the disclosure requirements about the companies listed as well as the activities by the brokers and dealers to ensure honest and fair dealing. There was no inclusion of a fidelity fund. Whilst several other pieces of legislation[50] were passed over the subsequent years, it was not until the difficult years of 1968-1970 when there were extremely high volumes of transactions conducted. These volumes caused a 'paperwork crunch' that was quickly followed by a stock price decline.[51] Ultimately, many brokers were unable to meet customer obligations and went bankrupt, with public confidence in the stock market again at a low

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[48] Robert Sobel, *The Big Board: A History of the New York Stock Market* (Beard Books, 2000).
[49] US Securities and Exchange Commission, *What We Do* (10 June 2013) US Securities and Exchange Commission < https://www.sec.gov/Article/whatwedo.html>.
[50] Trust Indenture Act of 1939; Investment Company Act of 1940; Investment Advisers Act of 1940.
[51] Robert Sobel, above n 48.

point.[52] Congress acted by passing the Securities Investor Protection Act of 1970, 15 U.S.C. § 78aaa, which created the Securities Investor Protection Corporation (SIPC). Similar to the SEGC in Australia, the SIPC manages a fund to compensate investors where the member of a stock exchange becomes unable to meet customer commitments. "From its creation by Congress in 1970 through to December 2016, SIPC advanced $2.6 billion in order to make possible the recovery of $137.6 billion in assets for an estimated 773,000 investors".[53] Those numbers include the response to collapses of many brokers, including large organisations such as Lehman Brothers Inc (2008), Bernard L Madoff Investment Securities LLC (2008) and MF Global Inc (2011), constituting the eighth largest bankruptcy in history. In 2007, "The National Association of Securities Dealers and the member regulation, enforcement and arbitration functions of the New York Stock Exchange merged to form FINRA (Financial Industry Regulatory Authority), the largest non-governmental regulator for securities firms doing business in the United States".[54]2007 marked the first calendar year for the SIPC in which there were no proceedings for customer protection.

The approach to protecting investing consumers in the USA, from the early days of trading in the street until the 1970s, relied heavily on the importance of honest dealings by brokers, and internal licensing and regulation of those brokers.[55] That approach did not, however, avoid the situation where brokers were not able to meet their financial commitments with their customers and many customers lost money. It took a significant event before the Federal Government took legislative action and created a fund to compensate consumers, as it was not possible to completely avoid brokers going bankrupt.[56]

4.3.4 European Union

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[52] Securities Investor Protection Corporation, *History and Track Record* (2018) Securities Investor Protection Corporation < https://www.sipc.org/about-sipc/history>.
[53] Ibid.
[54] US Securities and Exchange Commission, above n 45.
[55] Ibid.
[56] Robert Sobel, above n 48.

Amongst the many regulations and directives from the highest level of legislative power in the EU, a number of instruments have been developed to regulate financial markets. The greater emphasis in the EU has been on promoting markets to be fair, transparent, efficient and integrated.[57]

Furthermore, the internal market was designed to allow businesses to move from state to state with little extra red tape, if any at all. In 1993, Directive 93/22/EEC was introduced with the purpose of "granting a passport for EU securities firms to conduct cross-border operations anywhere in the EU based on a license issued by their respective home states".[58] This directive was to provide that a dealer in securities would be licensed and regulated in their home state and be able to operate in other states without further administrative burdens. Whilst the concept of this proposal was clear, most Member states were concerned about how the then current national legislation would be changed to meet such a demanding change. They did agree and the Directive was enabled.[59] A further directive in 1997, Directive 97/9/EC, required Member states to provide for an "investor-compensation scheme" where:[60]

> Each Member State shall ensure that within its territory one or more investor-compensation schemes are introduced and officially recognized.
>
> Cover shall be provided for claims arising out of an investment firm's inability to:
>
> > repay money owed to or belonging to investors and held on their behalf in connection with investment business,
>
> or
>
> > return to investors any instruments belonging to them and held, administered or managed on their behalf in connection with investment business.

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[57] European Commission, *Investment services and regulated markets - Markets in financial instruments directive (MiFID) (*2018) European Commission <https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-markets/securities-markets/investment-services-and-regulated-markets-markets-financial-instruments-directive-mifid_en>.

[58] Manning Gilbert Warren III, 'The European Union's Investment Services Directive' (1994) 15(2) *University of Pennsylvania Journal of International Law* 181.

[59] Ibid 183.

[60] Directive 97/9/EC Article 2 (1-2).

An inquiry into the effectiveness of the implementation of that Directive[61] found that in certain circumstances the fund was not sufficient to fulfil obligations, and that some claims processes were very slow. However, "the overall message is that the investor compensation schemes work fairly well and that they play an important complementary role in providing last-resort protection for retail investors".[62] Whilst there were efforts, in 2010, by the European Commission to update the rules, the proposal was withdrawn in March 2015.

Further legislation, with the aim of strengthening the 'single market' goal, came in the form of Directive 2004/39/EC that governed both the banking and financial services offerings as well as traditional and alternatives stock exchange venues. Although delivering anticipated greater choice and lower cost for investors, the financial crisis of 2008 exposed some shortcomings. The most recent legislation, Directive 2014_65_EU and Regulation (EU) No 600/2014, was aimed at updating previous legislation to further address issues such as: [63]

- Lack of level playing field between markets and market participants
- Difficulties for SMEs to access financial markets
- Lack of transparency for market participants
- Lack of transparency for regulators and insufficient supervisory powers in key areas
- Obstacles to competition in clearing infrastructures
- Weaknesses in some areas of the organisation, processes, risk controls and assessment of market participants
- Insufficient investor protection

The last item of Investor Protection refers to a lack of clarity of information provided about products as well as an uneven coverage of service providers.

As a reminder, the Directives developed by the EU are to be implemented by member countries into the local national legislation whilst keeping any existing legislation that may provide a greater benefit to the community.

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[61] European Commission, 'Evaluation of the Investor Compensation Scheme Directive' (European Commission, 2005) <https://ec.europa.eu/info/system/files/evaluation-investor-compensation-scheme-directive-022005_en.pdf>.

[62] Ibid.

[63] European Commission, 'Commission Staff Working Paper Executive Summary Of The Impact Assessment' (European Commission, 2011) <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52011SC1227&from=EN>.

4.3.4.1 Funding Arrangements

The first major point of difference is that some Member states implemented a 'customary' compensation fund where broker members were levied annually, based on certain criteria (discussed below). The funds then accumulated and when a broker defaulted, claims were assessed and paid as required from the fund. This method was called *ex-ante.*[64] Of the (then) 15 Member states, those using this method were Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Netherlands, Spain, and the United Kingdom. The Member states of Austria, Italy, Luxembourg, Portugal and Sweden each levy the member brokers a fixed fee, calculated annually, to fund the administrative costs of the scheme.[65] In the event of a default, and compensation payments having to be made, the brokers were levied to cover the amount of the total payment. The levy after compensation payments were made was termed *ex-post*. The Netherlands had two schemes, one of which combined the bank deposit scheme and also covered investments, with the bank acting as the broker (Collective Guarantee Scheme (CGS)), whilst the other covered only non-bank investment brokers (Investor Compensation Scheme (ICS)).[66] The CGS was a mixture of administrative fee and ex-post levy whilst the ICS was based on an ex-ante levy only. To those Member states using the ex-post method a line of credit was made available with their National finance department to make the compensation payments, and the line of credit was repaid upon collection of the ex-post levies.

4.3.4.2 Firm Contributions

Each Member state that levies on an ex-ante basis uses a slightly differing system, and several examples are provided.

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[64] Ian Babetskii, Lubos Komarek and Zlatuse Komarkova. 'Financial integration of stock markets among new EU member states and the euro area'. (Research Paper, Czech National Bank, August 2007).
[65] Ibid.
[66] European Commission, above n 56.

In France, the fund manager each year nominated the amount to be collected and contributions were weighted according to the firms' financial capacity and operations.[67]

> More specifically, each firm's contribution is equal to the product of the overall amount of contributions to be collected and the net share of risk attributed to the firm. The net share of risk of a firm is the ratio of its net risk amount to the sum of all members' net risk amounts. The net risk amount is equal to the assessment base multiplied by a synthetic risk indicator.
>
> - The assessment base of members consists of one-half of the market value of the securities they hold and, for the non-bank investment firms, all of the related monies. The stated rationale for the different contributions for securities and cash is that cash is easier to misappropriate than securities.
> - The risk indicator depends on the firm's capital adequacy and its operating profitability, each of which is given a score from 1 to 3 (the higher the score, the lower the quality). For example, a score of 1 for operating profitability is assigned to institutions with a ratio of overheads and depreciation provisions to income that is lower than 65%; institutions with an operating ratio of more than 85% are assigned a score of 3. The two scores for capital adequacy and operating profitability are averaged, and, using linear transformation, translated into a weighting factor for the assessment base.
>
> Minimum annual contribution limits apply for institutions—the contribution may not be less than €800 for a non-bank investment firm and €400 for a credit institution.
>
> If the contributions raised are insufficient (e.g., in light of new large compensation cases), they may be increased during the calendar year.

In Germany, with the introduction of both the deposit-taking protection scheme and the investor compensation scheme, three different funds were created. *Entschädigungseinrichtung der Wertpapierhandelsunternehmen* (EdW) covers investment firms and any other firm not involved in deposit-taking and not covered by either of the other two schemes.[68]

> For firms participating in the EdW, the annual contribution is determined by the scope of the licence issued by BaFin for rendering financial services.

[67] European Commission, above n 56, 39.
[68] European Commission, above n 56, 42.

> Contribution rates are graduated and amount to 0.35%, 1.1% or 2.2% of gross income from commissions, and, in some cases, gross income from financial transactions as shown in the annual accounts—contributions are graduated depending on a firm's licensed business activities and whether the licence authorises the firm to acquire ownership or possession of investors' funds or securities in order to trade in financial instruments for its own account or to conduct own-account trading for others. For example, the lower rate of 0.35% applies to brokers or portfolio managers that are not authorised to hold client assets; the 1.1% rate applies to broking or management activities where the firm is authorised to hold client assets; and the higher 2.2% rate applies to institutions that are also authorised to undertake own-account trading for others or to trade in financial instruments for their own account. The minimum contribution for all EdW- participating firms is €300.

In the United Kingdom, investor protection arrangements have been in place since 1988. With the introduction of the three Directives discussed above, the investor protection, deposit-taking guarantee and also an insurance policy protection scheme were brought under one umbrella being the Financial Services Compensation Scheme (FSCS). In terms of funding[69]:

> Each FSCS sub-scheme (i.e., deposits, insurance, investments) is further split into contribution groups. Firms are allocated to the groups according to their FSA permissions to carry out regulated activities. A firm could be allocated to one or more contribution groups (and sub-schemes), by virtue of its permitted activities. Compensation payments arising from claims against a specific contribution group can only be levied from firms within that specific group. The aim is to avoid cross-subsidy between firms engaged in dissimilar business activities; for example, an institutional fund manager is not required to contribute to the costs of paying claims arising from the failure of a retail stockbroker. However, all firms contribute to the scheme's management expenses.

The contribution groups and tariff base for calculating contributions is detailed in the table below.[70]

Contribution groups of investment sub-scheme	**Regulated activity**	**Tariff base**

[69] European Commission, above n 56, 131.
[70] European Commission, above n 56, 132.

Fund managers	Managing investments	Funds under management
Managers of CIS and depositaries	Establishing, operating or winding up a CIS; acting as trustee or depositary	Gross income
Dealing as principal	Dealing in investments as principal	Number of traders
Advisory brokers—holding client money or assets	Dealing in investments as agent and arranging deals (permitted to hold client money, and safeguard and administer investments)	Number of approved persons
Advisory brokers—not holding either client money or assets	As above, but not permitted to hold client money, or safeguard or administer investments	Number of approved persons
Corporate finance advisory firms	Permitted to carry out corporate finance business but not other investment business	Number of approved persons
Pensions review	The costs of processing claims from the ongoing pensions review, which affects different types of business, have been ring-fenced and given a separate temporary contribution group	

Table 4.1

> Although compensation costs (and specific management expenses) can only be levied from the contribution groups in which the costs are incurred, the FSCS may use any excess funds of one contribution group (or sub-scheme) to cover the costs of another. However, this requires that the creditor contribution group (or sub-scheme) is not disadvantaged; for example, interest must be credited to the group (or sub-scheme).[71]

As can be seen from these example Member states, the methods of calculation vary, which reflects the introduction of multiple Directives contemporaneously as well as pre-existing schemes.

4.3.4.3 Compensation Claims

Amongst the other information provided by the external report, the volume of firm failures and compensation claims varies quite dramatically. The numbers from the United Kingdom are not explicit in terms of investment broker failures, but most of the numbers shown include both Independent Financial Advisors and Investment Managers and Brokers.

Year	1999	2000	2001	2002	2003

[71] Ibid.

Failures	661	360	284	139	164

Table 4.2

In stark contrast, "the Swedish investor compensation scheme has had no compensation events since its establishment. On average, one or two firm failures have occurred each year, but so far none of these has led to compensation claims as clients' assets have been appropriately segregated".[72]

Spain reported only one firm failure since the implementation of the ICD, while there were zero in Portugal, four in the Netherlands, zero in Luxembourg, two in Ireland, five in Greece, fifteen in Germany, zero in France, zero in Finland, one in Denmark, one in Belgium, and zero in Austria. Italy reported the following numbers in the table.

Year	1998	1999	2000	2001	2002	2003
Failures	7	2	3	1	2	2

Table 4.3

The main issues identified in the review were the slow processing of claims, and in some cases a shortfall of funds. However, "the overall message is that the investor compensation schemes work fairly well and that they play an important complementary role in providing last-resort protection for retail investors.[73]

4.3.5 Summary – Stock Exchange Schemes

The financial practice of buying and selling shares in companies has grown from occurring in an unregulated marketplace to a highly regulated marketplace where billions of dollars can change hands each day. The managers of the more modern marketplaces as well as the government of the day realised that the public must have confidence in that marketplace. To dispel any concern that a consumer who was party to a transaction with a broker may lose their money if the broker were to become insolvent or bankrupt, authorities created a fidelity fund or compensation scheme to ensure that funds were returned to consumers should a broker insolvency occur.

[72] European Commission, above n 56, 123.
[73] European Commission, above n 56, 10.

It can be easily assumed that the number of individuals, who invest in the stock exchange as consumers, is very low compared to the number of regular consumers. According to Caitlin Fitzsimmons, “the vast majority of Australians have never invested in shares, and there's no great mystery why – they can't afford it”.[74] Therefore, the NGF, and similar funds in the USA and EU, were created with all of their overheads for a minority of consumers. There is potential for the creation of a similar style of compensation fund to protect consumers in the remainder of the marketplace of Australia and their active entitlements they may hold when a company ceases to trade. From this example, it can be seen that regulatory measures built to manage the benefit provider does not necessarily avoid them going into insolvency even with command-and-control regulatory measures being implemented. Another scheme, developed for a minority of consumers in Australia, involves home renovators and builders.

4.4 Home Building Insurance Schemes

In this section only Australian schemes have been considered, mainly because the USA and EU do not legislate mandatory schemes. The comparison shown here will be between states as the legislation is not federal but state based. The use of mandatory insurance schemes is a possible solution to the thesis topic. According to statistics from ASIC regarding companies entering into external administration over the four financial years ending June 2017[75], an average of almost 18% of companies had the classification of ‘Construction’.[76] After the group of unclassified entries, Construction is the next largest. The Australian Bureau of Statistics (ABS) estimates that for the quarter ending September 2017 there was $27.5 billion

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[74] Caitlin Fitzsimmons, ‘Why most Australians don't invest in shares’ *Sydney Morning Herald (Sydney, Australia),* 8 December 2017.

[75] ASIC, *Insolvency statistics - Series 1A Companies entering external administration - by industry* ASIC (20 October 2014) < http://download.asic.gov.au/media/4592525/asic-insolvency-statistics-series-1a-published-january-2018.pdf>.

[76] Industry information aligns with the 2006 Australian and New Zealand Standard Industrial Classification (ANZSIC) divisions; ASIC, *How to interpret ASIC insolvency statistics* ASIC (20 October 2014) < http://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/how-to-interpret-asic-insolvency-statistics/>.

of building work completed in Australia.[77] That number includes about $16 billion dollars of residential work completed, making the annual residential building work turnover approximately $64 billion. In the same report[78] the ABS noted that over 54,000 private dwellings had commenced. Whilst the numbers were much smaller in the early- to mid-1900s, a relatively small number of companies entering into insolvency, causing home builders grief, the politicians of the time were urged to legislate in an attempt to curb the problems of the time and also 'clean up' the industry.

In the Western Australian Parliament in September 1939 the Builders' Registration Bill was debated. Mr Needham, the Member of Parliament who introduced the Bill to the Legislative Assembly, made the following declaration[79]:

> If the Bill is passed we shall ensure that none but the competent and reputable persons will be entrusted with the construction of buildings and other structures; the possibility of incompetence, fraudulent practice or negligence will be removed; a greater degree of security to the investing public and the community will be assured; the proper and safe control of operations on building construction, having regard to the safety of the workmen employed and the public will be secured; and the speculative element in building, with its seasonal dislocation of the industry and those engaged in it will be eliminated as far as possible.

The Bill was passed and enacted.

Similar actions occurred in other Australian States. Not until May 1971 did New South Wales consider licensing builders when Mr Morton, Minister for Local Government and Highways, read the Builders Licensing Bill a second time[80]:

> In my speech on the motion for leave to introduce this measure, I alluded very shortly to the fact that for many years representations have been made for

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[77] Australian Bureau of Statistics, *8752.0 - Building Activity, Australia, Sep 2017* ABS (17 January 2018) <http://www.abs.gov.au/ausstats/abs@.nsf/0/4FB5ACFC0074529ECA2576B00017C434?Opendocument>.

[78] Ibid.

[79] Western Australia, *Parliamentary Debates*, Legislative Assembly, 6 September 1939, 527 (Mr Needham), 529.

[80] New South Wales, *Parliamentary Debates*, Legislative Assembly, 4 May 1971, 594 (Mr Morton - Minister for Local Government and Highways).

> the registration of builders. I referred also to the report of the select committee of this House on the building industry.

An Opposition Member of Parliament, Mr Mahoney also made reference to historical issues within the industry[81]:

> For many years there has been a great deal of agitation in the community to license builders and to place some controls on the industry to rectify obvious ills that have developed rapidly in recent years, especially that of builders becoming insolvent.

The NSW Bill to license builders also contained provisions to require a builder to notify the board of the building agreement they were entering into, and they were to pay a prescribed insurance premium, ensuring that the homeowner would be covered should the builder be unable to complete the project.[82]

In a submission to an Inquiry into Builders Warranty Insurance, conducted by the Legislative Council Standing Committee on Finance and Public Administration of Victoria, Tim Holding, Minister for Finance, Workcover and the Transport Accident Commission, reported that[83]:

> Before 1972, there was no specific consumer protection in Victoria relating to residential housing construction contracts. In the event of failure by the builder to carry out the full terms of the contract, homeowners could rely only on the general legal remedies available for breach of contract.

Mr Holding went on to report that it was the Housing Industry Association (HIA) that had established an optional scheme in 1972 and a new, mandatory scheme was developed in 1974 under the Housing Builders' Association Ltd. A second or 'rival' scheme was developed by the Master Builders Association with the two funds merging in 1984 to form the Housing Guarantee Fund Limited under the control of the Minister for Consumer Affairs.[84]

In Queensland the registration of builders was the first attempt at controlling the building industry with the introduction of the Builders' Registration Bill by

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[81] Ibid 603.
[82] Ibid 599.
[83] Tim Holding, 'Victorian Government submission to the Legislative Council Standing Committee on Finance and Public Administration Inquiry into Builders Warranty Insurance (Submission 36)' (Victorian Government, January 2010) <https://www.parliament.vic.gov.au/images/stories/documents/council/SCFPA/BWI/Submissions/Sub_36_-_Government.pdf>.
[84] Ibid.

the Hon. A.M. Hodges, Minister for Works and Housing[85], who stated the following in his initial address:

> The primary objective of the Bill is the regulation of the building industry so as to protect the community against inefficient and unscrupulous operators within the industry. As an integral part of the means by which the objective is realised, the Bill will ensure a general improvement in the standard of building construction. The most significant and fundamental feature of the Bill is the creation of a class of person known as a "registered builder" and the Bill provides that subject to certain exemptions, no person other than a registered builder may carry out building construction to a value of more than $4,000 at any one time.

Five years later the Queensland Parliament enhanced their efforts to solve the problem of builders becoming insolvent. The House-builders' Registration and Home-owners' Protection Bill was introduced by Mr Lee, Minister for Works and Housing, with this emphatic statement:

> It is my opinion that the House-builders' Registration and Home-owners' Protection Bill will be one of the most significant pieces of legislation placed before State Parliament. This Bill is important because it provides security for the Queenslander who desires to have his own home built by a house builder or alterations, renovations, etc. carried out. In the main, the security is provided by a comprehensive insurance scheme that will mean that the owner's worry and stress, associated with any form of house-building activity, will be considerably reduced, if not eliminated altogether.

In South Australia the *Builders Licensing Act 1967* (SA) was first introduced to regulate the building industry. That Act was repealed with the introduction of the *Builders Licensing Act 1986* (SA), which then included provisions for insurance of the building project and protection for the homeowner.

The aim of the insurance scheme has been to compensate consumers who are part of a select group of people building a new home or making home renovations through a licenced builder, as part of which the building value is greater than a regulated amount.[86] However, all schemes other than the

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[85] Queensland, *Parliamentary Debates*, Legislative Assembly, 7 December 1971, 2622 (A Hodges, Minister for Works and Housing).

[86] Minimum building values are: $12,000 (ACT), $20,000 (NSW), $20,000 (NT), $3,300 (QLD), $12,000 (SA), $12,000 (TAS), $12,000 (VIC), $20,000 (WA)

Queensland scheme are last-resort schemes in the sense that the consumer must take all other avenues before being entitled to claim on the insurance policy that they have had to pay for. The Queensland scheme is a first resort scheme where the consumer may immediately claim some allowable trigger that has occurred. All schemes cater for the situation of the builder entering insolvency.

Where the schemes are privately insured, insurance companies will be able to apply to the relevant government department to become a valid insurer. The legislation in each state specifies the minimum insured value. The insurance companies then vet each builder, which is the entity that applies for the insurance on behalf of the consumer, to ensure the credentials of the builder. An insurer may not provide insurance to a builder if they consider the risk too high. No council authorities will allow a building project to go ahead without a valid insurance policy in place.[87]

4.4.1 Home Building Insurance Summary

What is quite clear in this example, is that significant regulation in a very defined industry was not capable of quelling the issue of companies failing and leaving the consumer stranded. After an evolution of legislation, a specific remedy, in this case the introduction of a mandatory insurance scheme was the only real way of protecting the consumer. This is another example of command-and-control regulation, which was fit-for-purpose. In the twelve months to May 2018, there were 465,788 settled house and unit transactions in Australia.[88] In the calendar year 2017, 114,087 new houses commenced and 99,087 new units were under construction, totaling 214,875.[89] This demonstrates that there is a select group of consumers in any one year that is

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<https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Completed_inquiries/2008-10/home_warranty_08/report/e03>.

[87] Australian Government, *Summary of Australian building regulation and home warranty insurance schemes*, Senate Standing Committees on Economics, Parliament of Australia <https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Completed_inquiries/2008-10/home_warranty_08/report/e03>.

[88] Cameron Kusher, *Fewer Transactions Are Occurring Across The Housing Market* (2 July 2018) CoreLogic < https://www.corelogic.com.au/news/fewer-transactions-are-occurring-across-housing-market>.

[89] Housing Industry Association, 'Window into Housing 2018' (Fact sheet, Housing Industry Association, June 2018).

singled out for specific protection and yet there is no such solution for the majority of all Australians who are consumers.

4.5 Employee Entitlements Schemes

4.5.1 Australia

The issue of corporate insolvency and the effects it has on workers did not become a public concern until the late 1990s in Australia. Until then, and even today, the insolvency priority list would pay workers' entitlements, if there were sufficient funds, after eleven other items.[90] In NSW there were several mine closures at the Oakdale Colliery, Woodlawn mine and Cobar's copper mine.[91] A waterfront dispute between unions and the Patrick Stevedoring company resulted in the cancellation of many labour contracts. Further closures of National Textiles in NSW and Braybrook in VIC affected workers in the textile industry.[92] In 2001, the collapse of the relatively new company One.Tel, the leading insurance company in Australia, HIH, and the highly regarded and highly staffed Ansett Airlines all created concerns for members of the Australian Parliament.[93] It must be stated that governmental approaches to these issues were very much dependent on which government, Labor or Liberal, were in power at the time.

As late as 1998, Australia had not implemented any legislation with regards to securing employee entitlements should an employer enter into insolvency. This was clearly stated by Mrs Janice Crosio, Member for Prospect, when she read the Employee Protection (Wage Guarantee) Bill 1998 for the second time[94]:

> Guaranteeing workers' entitlements in the event of company insolvency is one of the most important reforms yet to be undertaken by an Australian government. Australia has a fine record when it comes to the introduction of

[90] *Corporations Act 2001* (Cth) s556.
[91] Frank Clarke et al, *Corporate Collapse: Accounting, Regulatory and Ethical Failure* (Cambridge University Press, 2003).
[92] Ibid.
[93] Ibid.
[94] Commonwealth, *Parliamentary Debates*, House of Representatives, 6 April 1998, 2540 (Mrs Crosio).

> social legislation. We were one of the first countries in the world to introduce workers' compensation, and we were the first to grant child endowment payments to mothers and introduce long service leave to workers. And yet, when it comes to guaranteeing workers' entitlements against an employers' insolvency or providing them with the utmost priority against all other creditors, Australia has neither. The rest of the world has passed us by. In this respect, our proud tradition of social reforms stands diminished.

Mrs Crosio was a member of the Opposition Party at the time of the introduction of her private member's Bill that was ultimately not enacted. Mrs Crosio made several attempts at introducing such legislation, all of which were not enacted. Her attempt in 1998 was in response to the mining closures in NSW as well as a meat works closure in Grafton, NSW.

> As it stands at the moment, at least 3000 Australian workers are owed roughly $20 million in their legal entitlements due to company insolvency. This is a disgraceful figure, but it should not be a surprising one. It is estimated that 13,000 businesses and companies become insolvent each year in this country, leaving at least 20,000 workers out of a job. Of course not all of these ex-employees are left without their entitlements but a good many are.[95]

The Government of the day reacted in small, distinct measures. According to Steve O'Neill[96], Parliament passed an Act to allow miners to access a trust fund created to accumulate funds for coal miners' long service leave. The *Coal Mining Legislation Amendment (Oakdale Collieries and others) Act 1999* (Cth) was required as the trust fund was administered under Commonwealth legislation and could only disburse funds for long service leave. The Government also produced a discussion paper with two options to resolve the situation on a broader level. One option was based on funding from general revenue from the Commonwealth and also State governments on a 50/50 basis. Where a State did not contribute, the benefits to workers would only be fifty percent of the amounts decided upon. The second option was an insurance scheme where companies would be required to contribute to

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[95] Ibid.

[96] Steve O'Neill, *Meeting employee entitlements in the event of employer insolvency* (4 April 2011) Parliament of Australia <https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/BN/1011/EmployeeEntitlements>.

premiums.[97] The Australian Chamber of Commerce and Industry (ACCI) were against the insurance option[98]:

> ACCI strongly rejected the insurance levy or compulsory contribution option ... Council reiterates its opposition to the establishment of a levy or contribution obligation on employers to ensure payment of Employee Entitlements. Such a measure would be counterproductive, and could only have the effect of tying up scarce investment capital, and therefore damaging employment... such a scheme would be an overreaction to a limited problem

Under the existing *Financial and Management Accountability Act 1997* (Cth) the Government released the Employee Entitlements Support Scheme (EESS) on 8 February 2000. This scheme was then used to assist the textile industry workers. Union opposition to the scheme continued, as it did not adequately cover a range of issues.[99]

When Ansett Airlines collapsed in 2001, the Government decided on a new, distinct strategy that comprised:

- establishing a new government-funded employee entitlements scheme, to meet the costs of Ansett staff terminations;
- imposing an airline ticket surcharge of $10.00 to meet the costs of the Ansett terminations and countenancing the imposition of similar surcharges in other industries;
- ranking wage earners ahead of secured creditors in the access to liquidated assets of failed businesses; and
- replacing the EESS scheme with a more generous General Employee Entitlements Redundancy Scheme (GEERS), which was not reliant on the States contributing to the scheme.

The airline ticket levy was terminated in 2003. The major differences between the EESS and the GEERS schemes were that there was no longer a requirement for State governments to contribute and secondly, the entitlements were slightly higher. There was also Government consideration of changing the Insolvency Laws such that in the liquidation process employee entitlements might rank higher than secured creditors.[100]

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[97] Steve O'Neill, above n 82.
[98] Steve O'Neill, above n 82.
[99] John Burgess and Marian Baird, 'Employment entitlements: Development, access, flexibility and protection' (2003) 29(1) *Australian Bulletin of Labour* 1.
[100] Ibid.

The most recent legislation was the *Fair Entitlements Guarantee Act 2012* (Cth), which provided a legislative basis for what had previously been GEERS.

> The *Fair Entitlements Guarantee Bill 2012* (the Bill) will replace the administrative General Employee Entitlements and Redundancy Scheme (GEERS) which currently assists employees who have lost their employment due to the liquidation or bankruptcy of their employer and who are owed certain employee entitlements.[101]

For a long time, a number of industry groups created their own form of securing some of the employees' benefits and also making those benefits 'portable', as employees moved frequently between employers. The Coal Mining Industry (Long Service Leave) Corporation, mentioned earlier, was established in 1949 as a long service leave (only) trust and others include Long Service Payments Corporation (NSW) in 1975, Q Leave (QLD) in 1992 and NEST in July 2001.[102] Several other trusts were formed for the purpose of securing severance payments such as the Building Employees Redundancy Trust (QLD) in 1989, South Australia's Building Industry Redundancy Scheme Trust (BIRST) (SA) in 1989, and the Mechanical and Electrical Redundancy Trust (MERT) in 1988.[103]

Of particular note is NEST, or the National Entitlement Security Trust, as the Australian Metal Workers Union was the driving force behind this entity. It was established in 2001 in response to the turmoil of large corporate collapses and little in the way of governmental support, although the union colleagues in parliament were attempting to achieve the latter. With the introduction of the high profile trust the Australian Government acknowledged the existence of such vehicles and included their definition and procedures as needing to be endorsed within the Taxation legislation.[104] The current facilities provided by NEST include[105]:

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[101] *Fair Entitlements Guarantee Bill 2012* (Cth).
[102] Helen Anderson, *The Protection of Employee Entitlements in Insolvency: An Australian Perspective* (Melbourne University Publishing, 2014).
[103] Glenn Langton et al, 'Protection of Employee Entitlements in the Event of Employer Insolvency' (Institute of Actuaries of Australia, February 2003) <https://actuaries.asn.au/Library/Events/Conventions/2003/1200%20langton8f.pdf>.
[104] *Fringe Benefits Tax Regulations 1992* (Cth) s58PB.
[105] http://www.nest.net.au.

> The National Entitlement Security Trust (NEST) is a national industry trust established to safeguard the entitlements of employees. It is a not for profit trust open to any industry.
>
> Any type of non-superannuation entitlement covered by an employment agreement or award can be paid into NEST, the most common of which are annual leave, long service leave, sick leave, severance, redundancy and productivity payments.

The greater extent of the use of these types of facilities would reduce the reliance on, and responsibility of, the Australian Government under the *Fair Entitlements Guarantee Act 2012* (Cth).

4.5.2 USA

The 'system' that considers the protection of employee entitlements in the USA is vastly different to the one currently in place in Australia. Floyd reasons that this has to do with *National Character*.[106] She suggests that through the formation of the United States with the early involvement of the British, and the subsequent revolution and Declaration of Independence, the ultimate proposition was that Americans were 'free people' and that 'all men were created equal'.[107] Employment situations were such that the individual came to an agreement with the employer about work conditions and benefits. There were no major workers' unions as such and the more recent Employee Retirement Income Security Act (ERISA) requires that there should be a pension plan for an employee, but the investment decisions are up to the individual employee.[108]

In contrast, Floyd suggests that the Australian character in this context is one of 'collectivism' v 'individualism'. Such collectivism was triggered by the violent strikes during the adverse Australian economic conditions of the 1890s. Shortly afterwards the Australian Government implemented the *Conciliation and Arbitration Act 1904* (Cth), which essentially pitted groups of employees, usually represented by unions, against employer groups.

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[106] Louise W Floyd, 'Enron and One.Tel: Employee Entitlements after Employer Insolvency in the United States and Australia' (2003) 56 *Southern Methodist University Law Review* 975, 978.
[107] Ibid.
[108] Ibid 979.

The major disaster to hit the USA was the collapse of Enron Corporation in 2002. When a company collapses, employees in the USA have recourse under the Bankruptcy Code, and their entitlements are payable after secured creditors and administrative expenses. Those claims, however, have limitations. Each of the items, Wages, Leave Entitlements, Redundancy and Pension, have a maximum cap of $4,650 and can only represent values accrued in the 90 days up to the filing of bankruptcy.[109] Whilst there were many legal issues surrounding the Enron collapse, ultimately there were no, and there still are no, other legislative instruments that attempt to protect employee entitlements following the bankruptcy of their employer. It is up to the *individual*.

The failure of Enron and also WorldCom "resulted in intense scrutiny of and changes to the corporate governance regime in the United States by way of the *Corporate and Auditing Accountability, Responsibility, and Transparency Act* 2002 (known as the *Sarbanes-Oxley Act*)".[110] That Act did not impose any duty on directors to consider the interests of the employees.

4.5.3 European Union

In October 1980 the European Council, as it was known then, published Council Directive 80/987/EEC. Its preamble stated that:

> Whereas it is necessary to provide for the protection of employees in the event of the insolvency of their employer, in particular in order to guarantee payment of their outstanding claims, while taking into account of the need for balanced economic and social development in the Community.

The Directive acknowledged that there were some Member states that already had a facility in place to deal with this situation; however, there were many that had not. More specifically there was a wider list of concerns[111]:

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[109] Justice Simon Whelan and Leon Zwier, 'Employee entitlements and corporate insolvency and reconstruction' (2005) *Melbourne Law Review* .

[110] Ibid.

[111] Malcolm Sargeant, 'Implementation Report - Directive 80/987/EEC amended by Directive 2002/74/EC on the protection of employees in the event of the insolvency of their employer in the EU Member States ' (European Commission, 2007) <http://ec.europa.eu/social/BlobServlet?docId=4523&langId=en>, 2.

> These were that, firstly, there was inadequate protection for employees; secondly, that the assets of the business were often inadequate to meet the claims of employees; thirdly, that insolvency proceedings can take a long time and are difficult for employees to understand; fourthly, that there was a need for a special institution to safeguard employee claims; fifthly, that where such institutions exist they did so under widely differing terms; and, finally, that not to give equal protection to employees in all Member States would have an adverse effect on the development of the common market.

As with all Directives the aim was not to diminish any existing system but to ensure a minimum standard within all Member states. The original Directive was subsequently superseded by Directive 2002/74/EC and then Directive 2008/94/EC. There were many issues confronted by Member states with the introduction of the first Directive, even to the point of the first Article 1 (1), which states that:

> This Directive shall apply to employees' claims arising from contracts of employment or employment relationships and existing against employers who are in a state of insolvency within the meaning of Article 2 (1).

Many Member states had varying definitions of 'employee', 'employer' and 'insolvency', although Article 2 (1) did provide some definition. However, the overall premise, which the Member states had to navigate, was, according to Article 2 (2):

> This Directive is without prejudice to national law as regards the definition of the terms 'employee', 'employer', 'pay', 'right conferring immediate entitlement', and 'right conferring prospective entitlement'.

In the three years that Member states were given to implement the Directive, it was clear that they had to do so within the social justice measure that the Directive was offering whilst keeping the balance of the National law intact. After the three-year period the European Commission instigated a report, surveying the Member states about their progress, and providing detailed analysis of each Members' issues. Selective feedback included[112]:

> Belgium:

[112] European Commission, 'The Transposition Of Council Directive 80/987/Eec Of 20 October 1980 On The Approximation Of The Laws Of The Member States Relating To The Protection Of Employees In The Event Of The Insolvency Of Their Employer' (European Commission, 15 June 1995) <http://ec.europa.eu/social/BlobServlet?docId=3748&langId=en>.

Belgian law, by referring – within the context of implementing the Directive – to a specific definition of the term employer which excludes non-profit-making undertakings, limits the scope of the requirements laid down in the Directive.

Denmark:
Overall, Danish law gives no cause for objection.

Germany:
The same holds true for German law, which – as is the case for Denmark – contains a number of provisions more favourable for employees than those set out in the Directive.

Luxembourg:
The concept of insolvency does not appear to totally match the definition of insolvency given in the Directive.
Furthermore, under Luxembourg law the requirements of Article 8[113] of the Directive cannot be met at present.

The limited details provided here, although extensive in the initial report and subsequent reports[114], offer examples of the difficulties of imposing a new legal process on an existing legal infrastructure. The mechanism each Member state implemented varied, although many came in the form of a fund being financed in various ways. The guarantee scheme in France is operated by an insurance body and financed by "compulsory employers' contributions, which are linked to remuneration paid".[115] In Ireland there is the Social Insurance Fund where "the funding for the Social Insurance Fund itself comes from employees, employers and the national exchequer – thus employers contribute to the financing of the Social Insurance Fund via PRSI (pay-related

[113] Council Directive 80/987/EEC Article 8 - Member States shall ensure that the necessary measures are taken to protect the interests of employees and of persons having already left the employer's undertaking or business at the date of the onset of the employer's insolvency in respect of rights conferring on them immediate or prospective entitlement to old-age benefits, including survivors' benefits, under supplementary company or inter-company pension schemes outside the national statutory social security schemes.
[114] Sargeant, above n 94; European Commission, 'Report From The Commission To The European Parliament And The Councilon the implementation and application of certain provisions of Directive 2008/94/EC on the protection of employees in the event of the insolvency of their employer' (European Commission, 28 Feb 2011) <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52011DC0084&from=EN>.
[115] Sargeant, above n 94, 49.

social insurance) contributions".[116] Employers contributing 0.2% of employee wages finance the funds in Cyprus and Lithuania. Luxembourg imposes a 2.5% surcharge on personal income along with 4% on corporation tax.[117] In Portugal, the Fundo de Garantia Salarial financing "is assured by the employers by means of part of the charges contained in the social security and also by the State".[118]

The conclusion of the report from 2011[119] provides a positive response to the work carried out by the Member states:

> More than 30 years after the adoption of the original Directive in 1980, the Commission considers that it continues to play a key role in providing a minimum degree of protection of workers' rights in the internal market. Member States have been obliged to set up guarantee institutions that intervene in insolvency situations to cover employees' outstanding claims. The 3.4 million workers who have benefited from the safety net provided by the intervention of the guarantee institutions in the last four years, mostly in times of economic crisis, prove its usefulness. The revision carried out in 2002 clarified the legal consequences of transnational situations and adapted the provisions to take into account changes in the insolvency laws in the Member States, thus enhancing legal certainty.

4.5.4 Employee Entitlements Schemes Summary

The social disruption to employees and their families that is caused by the insolvency of employer companies has been a concern for the governments of Europe and Australia to the point of legislative intervention. This intervention has created safety mechanisms that assist the affected employees. As many companies operating in Australia employ staff in various jurisdictions a consistent approach would be most favourable. It is relevant to note that the systems put in place in this example are at the highest level of government, similar to the compensation schemes for stock exchanges. This would suggest that a scheme that is proposed to answer the thesis topic should also be at the highest level of government, especially as the legislation

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[116] Ibid 51.
[117] Ibid 60.
[118] Ibid 69.
[119] European Commission, above n 95.

covering the insolvency process is at a similar level. This example further advocates that a command-and-control style compensatory scheme provides the best outcome for individuals caused harm by a company entering into insolvency.

4.6 Travel & Tourism

> Travel & Tourism is a key sector for economic development and job creation throughout the world. In 2016, Travel & Tourism directly contributed US$2.3 trillion and 109 million jobs worldwide. Taking its wider indirect and induced impacts into account, the sector contributed US$7.6 trillion to the global economy and supported 292 million jobs in 2016. This was equal to 10.2% of the world's GDP, and approximately 1 in 10 of all jobs.[120]

Clearly an extremely important industry in many countries, there have been efforts to protect the industry, and indeed its customers or consumers, from events that may be out of the control of the consumer. One of those events could be the, usually sudden, insolvency of the travel agent or the actual service provider. The European Union and the United States of America have instituted measures to minimize the impact of insolvency of service providers on the consumer.

Being the large industry that it is, the United Nations has taken steps towards developing guidelines[121] for the measurement of the travel and tourism industry to enable a meaningful comparison of statistics between countries, geographic and economic regions.[122]

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120 World Travel and Tourism Council, *Global Economic Impact Trends 2020* (30 June 2020) World Travel and Tourism Council <https://wttc.org/Portals/0/Documents/Reports/2020/Global%20Economic%20Impact%20Trends%202020.pdf?ver=2021-02-25-183118-360>.

121 United Nations Department of Economic and Social Affairs, 'Tourism Satellite Account: Recommended Methodological Framework 2008' (United Nations, 2008) <unstats.un.org/unsd/publication/Seriesf/SeriesF_80rev1e.pdf>; United Nations Department of Economic and Social Affairs, 'International Recommendations for Tourism Statistics 2008' (United Nations, 2010) <unstats.un.org/unsd/publication/Seriesm/SeriesM_83rev1e.pdf>.

122 Maria Juul, *Tourism and the European Union* (September 2015) European Parliamentary Research Service <https://www.europarl.europa.eu/RegData/etudes/IDAN/2015/568343/EPRS_IDA(2015)568343_EN.pdf >, 3.

> Based on these guidelines, Eurostat (the Statistical Office of the EU) has published its own manual for tourism statistics, in which it defines tourism as 'the activity of visitors taking a trip to a main destination outside the usual environment, for less than a year, for any main purpose, including business, leisure or other personal purpose, other than to be employed by a resident entity in the place visited'

4.6.1 European Union

> Tourism plays a major role in the EU economy. According to the European Commission, it is the third largest socio-economic activity in the EU (after the trade and distribution, and construction sectors), and has an overall positive impact on economic growth and employment. Tourism also contributes to the development of European regions and, if sustainable, helps to preserve and enhance cultural and natural heritage.[123]

It was that level of importance of the tourism industry that led the European Commission to consider developing a Directive that would close the gap between Member states, as some had provisions to protect consumers but the majority had none.[124] The great focus in the 1980s was to create a single, cohesive and consistent market between the EU Member states. After a number of reports the EEC (as it was then) introduced Council Directive 90/314/EEC on 13 June 1990. The Directive related specifically to package travel, package holidays and package tours. Sections of the preamble explain the reasoning:

> Whereas one of the main objectives of the Community is to complete the internal market, of which the tourist sector is an essential part;
>
> Whereas the national laws of Member States concerning package travel, package holidays and package tours, hereinafter referred to as 'packages', show many disparities and national practices in this field are markedly different, which gives rise to obstacles to the freedom to provide services in respect of packages and distortions of competition amongst operators established in different Member States;

[123] Ibid 5.
[124] Ibid.

> Whereas both the consumer and the package travel industry would benefit if organizers and/or retailers were placed under an obligation to provide sufficient evidence of security in the event of insolvency;

Furthermore, the Official Journal of the European Communities No L 158/59 dated 23 June 1990 was more explicit, noting:[125]

> Whereas experience has shown that package travel, commonly paid for in full in advance of departure, has caused a certain level of dissatisfaction, and that the level of dissatisfaction is high enough to justify action, in the form of a Council directive, by the Community;

And

> Whereas both the consumer and the package travel industry would benefit if organizers were placed under an obligation to cover by means of insurance those parts of their liability under this Directive as are insurable; whereas, similarly, each Member State should ensure that within its territory a guarantee fund is available for payment of claims sustainable under this Directive which remain unpaid from some other source;

The Directive included requirements in a number of areas to strengthen consumer protection, along with the requirement to have a facility in place in the event of a travel service provider's insolvency.[126] With the 2015 report noting that "the Commission estimates that EU tourism industries comprise almost 2 million enterprises, most of them small and medium-sized enterprises (SMEs)"[127], there is a reasonable chance that some of those enterprises would not survive. In 2016 there were 169,455 corporate insolvencies, with the services sector contributing 38.4%.[128] Contemporary events that affect the viability of a company in the EU can include strong movements in currency, terrorism, Brexit and greater competitive activities.[129] The major problem when a company does fail, as happened when an English travel company collapsed in 2001, can be "leaving 43 people potentially stranded in various far-flung parts of the world and 79 others, who were

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[125] Official Journal of the European Communities, *Council Directive (90/314/EEC)* (26 June 1990) Eur-Lex < https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31990L0314&from=EN>.
[126] Ibid.
[127] Maria Juul, above n 121, 6..
[128] Creditreform, 'Corporate insolvencies in Europe - 2016/17' (Mandag Morgan, 2017) <https://www.mm.dk/pdfiles/Creditreform_2017.pdf>.
[129] World Travel and Tourism Council, above n 103, 8.

expecting to travel, without a holiday".[130] In the United Kingdom the issue has been managed well:[131]

> Since 1973, the Air Travel Organiser's Licence (ATOL) has protected people booking packaged holidays in the event that the firm goes bust; almost all the big travel firms operating in the UK are part of the scheme. It is funded by a £2.50 levy on each passenger booking.

All Member states of the EU have developed their own version of the ATOL compensation system in response to the 1990 Council Directive. More recently, new Directive (EU) 2015/2302 has been implemented to close some gaps the original Directive had left open, as well as ensuring that new activities created by greater use of the internet and self-booking were accounted for. Most specifically, the term 'packages' has been expanded to include not only those packages created before a sale (pre-packaged), but also any combination of two or more services created at a point of sale.[132] These services are referred to as linked services and referred to in Preamble (14):

> In order to ensure fair competition and to protect travellers, the obligation to provide sufficient evidence of security for the refund of payments and the repatriation of travellers in the event of insolvency should also apply to linked travel arrangements.

The concern over the insolvency issue was very clear and very explicit as Preambles (39-42) describe in detail what expenses must be covered and which enterprises must insure themselves. Further provisions were that if an enterprise is covered in one Member state but they also trade in another, they would not be required to be insured in both member states. This ensures one of the primary goals of the EU marketplace that there must be "free movement of services and the freedom of establishment".[133] The new provisions of Directive (EU) 2015/2302 had to be in place and effective by 1 July 2018.[134]

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[130] Travel, 'What recourse do you have if your travel company goes bust?' (2001) (7 April) *Travel* <http://www.telegraph.co.uk/travel/717800/What-recourse-do-you-have-if-your-travel-company-goes-bust.html>.
[131] Miles Brignall, 'Your holiday is booked – then the firm goes bust. Have you lost your money?' (2016) (22 July) *Money - Consumer Rights* <https://www.theguardian.com/money/2016/jul/22/booked-holiday-firm-goes-bust-lost-money-atol-logo>.
[132] Directive (EU) 2015/2302 Preamble (2).
[133] Directive (EU) 2015/2302 Preamble (42).
[134] Directive (EU) 2015/2302 Article (28).

4.6.2 USA

According to the website Trading Economics[135] "The US travel and tourism industry contributed nearly USD1.6 trillion to the US economy in 2015, or 2.6 percent of its GDP. Travel and tourism exports accounted for 11 percent of all US exports and 33 percent of all US services exports, positioning travel and tourism as the nation's largest services export".

Compared with the average of 10% of GDP across the world, perhaps the relatively lower contribution to GDP may create, or contribute to, the relatively low consideration of legislation by US states with regards to consumer protection in this economic sector.[136]

There are laws regarding travel in certain states of the USA and they vary from state to state. The combination of related laws is termed 'Travel Law' where:[137]

> Travel Law describes the nexus of federal, state, common law and international laws that regulate the day-to-day workings of the travel industry. The need for a body of law specific to the travel industry became evident with the deregulation of the travel industry that occurred in the 1970s. When the federally-mandated deregulation process was finished, the travel industry found itself in need of a central source of legal guidance where it could turn for its travel-specific issues, and the field of Travel Law was born. Travel Law incorporates elements of contract law, employment issues, tourism and hospitality procedures, anti-trust rules, regulatory and agency compliance, and knowledge of certain international treaties, into a comprehensive guide for the travel industry.

The state of California enacted the Seller of Travel Law in 1995, and created a fund and fund manager to benefit consumers located in California if their travel service provider was to become bankrupt. There is a registration requirement in conjunction with this fund for all sellers of travel services, with

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135 Trading Economics, *United States Tourist Arrivals* (21 Feb 2018) tradingeconomics.com <https://tradingeconomics.com/united-states/tourist-arrivals>.
136 Ibid.
137 Anolik Law Group, *Travel Law* Anolik Law Group <https://travellaw.com/page/travel-law-faq>.

a portion of fees going to the fund.[138] Other states such as Florida, Hawaii, Illinois, Iowa, Louisiana, Massachusetts, Michigan, New York, Pennsylvania, Virginia and Washington (State) involve registration with varying requirements to use trust funds and place surety bonds, but do not offer a consumer protection fund. Nevada does have a fund and requires both in-state and out-of-state service providers to contribute.[139]

There are no US federal laws that cover consumer protection if a seller of travel services becomes bankrupt or insolvent.

4.6.3 Australia

Regulation of the travel-related services industries in Australia has been somewhat disjointed and more recently disbanded. In the NSW Parliament in 1973, the first Bill to regulate travel agents anywhere in Australia was read for the second time.[140] The Minister stated:

> The bill, which introduces new legislation, will bring a measure of control to the activities of an industry which has not been previously affected by the laws of this State, or indeed of the Commonwealth. This legislation has become necessary owing to a number of disturbing occurrences, both here in Australia and overseas, as a result of which members of the public have been defrauded of substantial sums of money, have found themselves stranded in foreign cities and ports, and have been subjected to considerable personal inconvenience and unhappiness.

The NSW Parliament was concerned about 'fly-by-night' operators, and certainly about the collapse of several agencies that had resulted in the 'unhappiness' of consumers.[141] Included in the Bill was power to licence all travel agents in NSW but also the power to create a fidelity fund.

> It will have the power to establish a travel agents fidelity guarantee fund from which members of the public who may have a legitimate claim may seek to

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[138] Ibid.
[139] Ibid.
[140] NSW, *Parliamentary Debates*, Legislative Assembly, 25 September 1973, 1167-1176 (J B M Fuller, Minister for Decentralisation and Development).
[141] Ibid.

> recoup their losses if this cannot be achieved from the licensed travel agent with whom they were dealing.[142]

In support of the Bill, the Leader of the Opposition, Mr N Wran provided a broader perspective to the issues at hand:[143]

> The travel agent is, of course, an integral part of a large national and growing industry. The tourist industry is a most important one, not merely to New South Wales but indeed to Australia both in the domestic sense and in the number of overseas tourists who come here each year. It might interest honourable members, so that they may gauge how important the tourist industry is, to know that according to Mr G. W. L. Tucker, executive director of the Australian National Travel Association, which embraces about 850 members of the tourist industry, the tourist industry in Australia generates about $2,400 million a year - or to put it in percentage terms, 8 per cent of Australia's gross national product.

Ultimately other states enacted similar legislation and in 1986 some states (WA, NSW, Victoria, SA) signed an agreement acknowledging the need for a cooperative scheme with uniform provisions for licensing, and also that they had to participate in the Travel Compensation Fund which "made provision for payment of compensation to consumers who deal with travel agents that fail to account for money they receive".[144] That legislation and fund operated with small amendments, as required, until 2014.

In November 2010, a report was compiled by Price Waterhouse Coopers (PWC) for the Department of Treasury, on behalf of the Standing Committee of Officials of Consumer Affairs. The review of consumer protection in the travel and travel-related services market considered and reported on three main elements:[145]

1. identify and review the effectiveness of, or need for, consumer protection measures in the travel and travel related services market, particularly in relation to consumer prepayments for services

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[142] Ibid.
[143] Ibid 1169.
[144] AFTA, Submission to COAG Legislative and Governance Forum on Consumer Affairs, *Travel Industry Transition Plan - Consultation Draft*, October 2012, 2.
[145] Price Waterhouse Coopers, 'Review of consumer protection in the travel and travel related service market' (Australian Consumer Law, 2010) <http://consumerlaw.gov.au/files/2011/03/review_protection_in_travel_industry.pdf>.

2. consider the relevance, effectiveness and viability of the current travel agency regulatory scheme, with a particular focus on the operation of the Travel Compensation Fund (TCF)
3. identify and consider regulatory and non-regulatory options within a cost/benefit framework to address consumer protection issues at a Commonwealth and State/Territory level.

The Australian Government's response to that report was to create a draft Travel Industry Transition Plan[146] for further public consultation, and whilst there was a significant number of submissions[147], the Ministers for Consumer Affairs at their meeting of 7 December 2012[148] approved a Travel Industry Transition Plan, which provided:

a. a staged phasing out of the existing National Scheme, commencing with the proposed cessation of prudential supervision in mid-2013, followed by the repeal of travel agents' legislation by mid-2014;
b. reliance on the Australian Consumer Law ('the ACL') and other generic incorporation laws, as well as industry-led regulatory mechanisms and market based remedies such as credit card charge backs to protect consumers;
c. winding up the TCF and dedicating a proportion of remaining reserve funds (for those States and Territories who choose to adopt the TITP) to a range of purposes, including but not limited to:
    1. stakeholder communication and education initiatives both as part of the implementation process for the recommended reforms and on a long-term basis;
    2. one-off grant for consumer research and advocacy purposes;
    3. one-off grant to fund development of an industry-led accreditation scheme by a national working party of government, industry and consumer representatives, ; and
    4. paying any transitional compensation claims and the TCF's legal fees for undertaking cost recovery action relating to these claims; and

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[146] COAG Legislative and Governance Forum on Consumer Affairs, Parliament of Australia, *Travel Industry Transition Plan Consultation Draft* (2012).
[147] See for example Choice, Submission to COAG Legislative and Governance Forum on Consumer Affairs, *Travel Industry Transition Plan - Consultation Draft*, 3 October 2012; Insurance Council of Australia, Submission to COAG Legislative and Governance Forum on Consumer Affairs, *Travel Industry Transition Plan - Consultation Draft*, 29 August 2012; AFTA, Submission to COAG Legislative and Governance Forum on Consumer Affairs, *Travel Industry Transition Plan - Consultation Draft*, October 2012.
[148] Ministers for Consumer Affairs, *Joint Communique*, 7 December 2012.

d. funds will be redistributed according to the terms of the Trust Deed of the TCF.

In his speech in NSW Parliament for the second reading of the Travel Agents Repeal Bill 2013[149], the Minister explained that the Travel Compensation Fund only covered the instance where a member of the fund had failed. The TCF did not cover the failure of all service providers involved in the provision of services for a consumer's travel. It was also found that managing the TCF was costing a large amount of money, which was ultimately a burden on the travel agent members.

The end result in Australia today is that there is no legislative requirement for travel agents to be licenced. There is no travel compensation fund of any kind. It has been recommended by the Australian Federation of Travel Agents (AFTA) that consumers use a credit card to purchase travel services and rely on the credit card charge-back facility[150] should the desired services not be provided.[151] This was the recommendation in the PWC report, based on their finding that a large majority of travel consumers were purchasing their own services over the internet, bypassing travel agents.[152] The report also suggests that consumers may also rely on the ACL. It is important to further note that the Insurance Council of Australia, in their submission[153] to the draft TITP public consultation, emphasised that travel insurance does not provide compensation to the consumer for the insolvency of the travel agent, and business insurance typically does not either. In the jurisdictions included in this thesis there is an array of measures being employed in the travel and tourism industry to protect consumers with active entitlements. Surprisingly, legislators in Australia have considered less regulation to be a better option currently.

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[149] NSW, *Parliamentary Debates*, Legislative Assembly, 14 November 2013, 25794-5 (Anthony Roberts, Minister for Fair Trading).

[150] According to the Financial Ombudsman Service of Australia a chargeback is like a refund however it depends on the terms and conditions of the credit card provider https://www.fos.org.au/small-business/merchant-chargebacks/.

[151] Cordato Partners, *There's no longer any Travel Agents Licensing in Australia* (2018) Cordato Partners <http://www.tourismlegal.com.au/travel_agents_licensing.htm>.

[152] Price Waterhouse Coopers above n 121, 111.

[153] Insurance Council of Australia, Submission to COAG Legislative and Governance Forum on Consumer Affairs, *Travel Industry Transition Plan - Consultation Draft*, 29 August 2012.

4.6.4 Travel and Tourism Summary

The tourism industry has been shown to be a great contributor to employment and income for each of the three jurisdictions. The EU has taken measures to ensure that consumers, who book trips that involve any number of providers, would not be 'left out in the cold'. The EU system has been mandated across all member states. The USA abandoned its federal system and individual states have instituted their own, but the situation is not consistent across the country. Australia has abandoned its travel insurance system. These are mixed reactions to the same situation across the three jurisdictions. The introduction of a protection mechanism for consumers across Australia could provide support to consumers in Australia and as seen in the EU, a system consistent across all states would provide greater consumer confidence.

4.7 Specific Government Inquiries

Over the last several years there have been a number of Government-initiated inquiries into the consequences of company insolvency in Australia and the United Kingdom. The consumer issues arising when a company fails, particularly in the retail sector, were the pre-payment or payment of a deposit for goods not yet received as well as gift cards or vouchers purchased and not yet redeemed.[154] The area of pre-payments can be considerable and includes payment of memberships for up to twelve months in advance (gym memberships in particular), on-going payments to a 'membership' that results in a large hamper of goods at Christmas time, as well as loyalty schemes. It is relevant to review the options considered by these inquiries as they offer additional and valuable points of view from the Government as well as from individuals and groups who provided submissions.

4.7.1 Australia

[154] Christopher Symes and Beth Nosworthy, 'Prepayment Consumer Creditors: A Special Case for Insolvency Proceedings? (2017) 25 *Insolvency Law Journal* 29, 39.

In a review about gift cards in the Australian market, concluded in June 2012, the Commonwealth Consumer Affairs Advisory Council (CCAAC) found that:[155]

> In situations of insolvency, there are often insufficient funds to meet the claims of all creditors. In these circumstances not all interested parties will be able to recover the full amount they are owed. Substantive changes to improve the standing of gift card holders would necessarily come at the expense of other creditors. CCAAC is unaware of any compelling arguments as to why gift card holders should be treated differently to other unsecured creditors.

In a separate inquiry several years later:

> On 4 February 2016, the Senate referred the following matter to the Economics References Committee for inquiry and report by 12 May 2016:
>
> The causes and consequences of the collapse of listed retailers in Australia, with particular reference to:
>
> a. the conduct of private equity firms prior to, during and after corporate takeovers;
> b. the role of the Australian Securities and Investments Commission and the Australian Competition and Consumer Commission in overseeing corporate takeovers;
> c. the effect of the appointment of external administrators on secured and unsecured creditors, including employees and consumers of retail businesses;
> d. the effect of external administration on gift card holders and those who have made deposits on goods not delivered;
> e. the desirability of the following proposals in the event that gift card holders are unable to redeem their gift cards following the appointment of external administrators:
>
> i. placing an obligation on external administrators to honour gift cards,
> ii. a requirement that funds used to purchase gift cards be kept in a separate trust account by businesses,

[155] Commonwealth Consumer Affairs Advisory Council, 'Gift cards in the Australian market: Final Report' (The Treasury, Australian Government, 6 July 2012) <https://treasury.gov.au/publication/gift-cards-in-the-australian-market-report-2/gift-cards-in-the-australian-market-report/>, 53.

iii. directors to be personally liable for the value of gift cards purchased; and

f. any related matters.[156]

It must be noted that this inquiry lapsed due to the general election held on 2 July 2016, and on 11 October 2016 "the Senate agreed not to re-refer this inquiry in the 45th Parliament".[157] In his submission[158], Professor Christopher Symes from the Adelaide Law School stated that "in relation to (c) the effect of the appointment of external administrators on secured and unsecured creditors, including employees and consumers of retail businesses, I feel the present FEG Act provides enough protection for employees and consumers do need much more attention at the present time". Symes claimed that consumers who had not received goods or had not had the use of gift vouchers due to insolvency had to 'wait at the end of the line', and yet "this absence of statutory priority or trust disregards the fact that in certain industries it is common practice to pay in advance for the supply of goods or services".[159]

> One of my recommendations is that it is time for these issues to be considered by a special Inquiry conducted by the Australian Law Reform Commission on all matters relevant to consumers and insolvency. The administration of gift cards is only part of a larger concern of how we are treating consumers in corporate insolvency. Some consumers participate in loyalty reward schemes and will expect to claim their entitlements from time to time. Upon the liquidation of the companies associated with these reward schemes there is a risk that these 'entitlements' will be lost.

On the consideration of the use of a trust account for gift vouchers, the Law Council of Australia made further comment:[160]

> The Committees submit that the administrative burden of managing such an initiative would be counterproductive. Specifically, introducing substantial

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[156] Senate Standing Committee on Economics, *Causes and consequences of the collapse of listed retailers in Australia* Parliament of Australia <https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Dick_Smith>.

[157] Ibid.

[158] Professor Christopher Symes - Adelaide Law School, Submission No 13 to Senate Standing Committee on Economics, *The causes and consequences of the collapse of listed retailers in Australia*, March 2016.

[159] Ibid.

[160] Law Council of Australia, Submission No 3 to Senate Standing Committee on Economics, *The causes and consequences of the collapse of listed retailers in Australia*, March 2016.

> additional red tape and related cost over what will often be a multitude of relatively low dollar value transactions would not be justified to address this very specific category of potential stakeholder – gift card holders – recognising that the vast majority of retail trade is undertaken by solvent companies which honour gift cards on a daily basis.

Professor Symes also referred to other jurisdictions in his submission and referred to several inquiries in the UK, which culminated in a report handed to the UK Parliament by the Law Commission in 2016, entitled "Consumer Prepayments on Retailer Insolvency".[161] A discussion of the prior reports can be found in the precursor document Law Commission, *Consumer Prepayments on Retailer Insolvency: A Consultation Paper* (June 2015) CP221.

4.7.2 United Kingdom

The UK report not only covers the issue of prepayments, but also discusses gift cards and the use of trusts and Christmas saving schemes. In terms of trusts, they clarify how they may protect the consumer:[162]

> It is possible for retailers to ring-fence consumer prepayments by placing them in a trust. Where a trust is established, consumers are said to have a "beneficial interest" in the money. This means that, on insolvency, the prepaid funds still belong to the prepaying consumers rather than the business. The money does not form part of the company's assets so it is not distributed to creditors generally. Instead, if there are sufficient funds in the trust, consumers will receive their money back in full or, if there are insufficient funds to satisfy all claims, a pro rata payment.

They also were concerned that trusts can be burdensome for businesses and that the money must be kept separately. This can also be a commercial issue for many companies as they often rely on that cash flow to purchase more goods. Another alternative was for the company to purchase insurance to protect, in this case the prepayments, from the threat of insolvency. Previous inquiries had found through submissions that companies had found the cost of insurance quite high. "A further barrier is that any single retailer seeking

[161] UK Law Commission, *Consumer Prepayments on Retailer Insolvency,* Report No 368 (2016).
[162] Ibid 20.

deposit insurance in the absence of regulation or a voluntary code requiring it to do so is likely to be treated with suspicion". Inquiries into the insurance industry found that the demand for such insurance was low, but if a trade body was to require such a product it "might be more effective in encouraging the insurance market to develop affordable products".[163] The UK report also mentions that several industry sectors have their own codes of conduct that also require that prepayments be held in a trust account. The double glazing industry and the funeral planning sectors are such examples. Whilst the consideration for reform might reduce statistics to individual average losses that may be considered small, there are still large overall community losses, usually in the millions of pounds.[164] The use of the charge-back facility from credit and debit card providers was extensively canvassed as a way of recovering funds within a short timeframe. The last option was the consideration of altering the consumers' status in the insolvency hierarchy. Ultimately, the report handed the issue over to the politicians:[165]

> Giving preferential status to consumer claims involves a value judgment. In essence, the question is how far losses should fall on consumers or on banks and other institutional lenders. That is a political decision, which should be made by those who are elected to make these judgments.

The UK Government published a response[166] to the Law Commission's recommendations. The timing of the response, December 2018, came at a time of some turmoil within the government itself and also the intention of the UK to withdraw from the EU. The report acknowledged the plight of consumers at the time that companies become insolvent but could not clearly express a desire to change any legislation that may allow the Secretary of State to make decisions upon regulation of individual business sectors such as Christmas Savings Schemes. Further, it reiterated that the chargeback facility on certain credit cards might be a good short-term resolution for part payments or purchases of gift cards. The UK government decided not to take

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[163] Ibid 21.
[164] Ibid 28.
[165] Ibid 99.
[166] Department for Business and Innovation and Skills, 'Law Commission report on consumer prepayments on retailer insolvency: government response' (UK Government, December 2018) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767922/law-commission-report-government-response.pdf>.

any further action regarding any change to the insolvency hierarchy and used the issues with the government of the day to delay any other considerations.

4.7.3 Specific Government Inquiries Summary

The examples shown in this section indicate that government is certainly concerned about the harm caused to consumers who have either gift cards or a pre-payment that could not be honoured by the provider concerned due to insolvency. The key point for this thesis is that statistics, and therefore the measure, of the harm caused by these situations and that of a consumer holding an unexpired warranty, are not clearly identifiable. Whilst is was earlier presumed at step two of the six-step approach to consumer policy issues[167] (end of 3.1.2.1) that the value might be considerable given the Consumer Surveys, more complete and reliable information would make the decision-making task more credible and transparent.

4.8 Bank Deposit Insurance Scheme

The preceding sections have highlighted the protection afforded to specific consumer groups that had been caused harm. The solutions to those situations are quite specific to those relatively small consumer groups. This section discusses a solution that has been applied to most consumers in Australia, the USA and most EU countries as well as many other countries worldwide. Almost all consumers in capitalist countries will be customers of a banking or financial institution at some point and will benefit from the protection mechanisms that the host countries have now implemented. It is submitted that those same banking consumers could be subject to the harms caused by other companies that cease to trade, and therefore this section was most relevant to the consumers who are the focus of this thesis.

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[167] Policy and Research Advisory Committee of the Standing Committee of Officials of Consumer Affairs, 'Consumer policy in Australia: A companion to the OECD Consumer Policy Toolkit' (March 2011) <https://consumerlaw.gov.au/sites/consumer/files/2015/09/Companion_to_OECD_Toolkit.pdf >..

Bank deposit insurance schemes, or deposit protection schemes, "are public authorities designed to reimburse depositors in place of their financial institution, when the latter is insolvent".[168] In general terms, whilst a bank may be licensed as a deposit taking institution, the other half of their business is to also loan money to others. Not a lot of depositors' cash, therefore, is kept at the bank, subject to prudential standards,[169] and when there is a financial concern, many depositors rush to the bank to withdraw their cash, and that can be quite a concern when depositors cannot get at their money. The issue of a bank becoming insolvent occurred in the early 1800s in the USA and in the decades afterwards the first deposit insurance scheme was developed. A similar concern raised itself in Czechoslovakia in 1920 and deposit protection schemes began to surface in Europe in response.[170] The Deposit Insurance Scheme (DIS) became part of banking culture within the USA from 1829 when the states individually provided banking licenses and provided varying prudential regulation. After several more bank insolvencies in the USA the Federal government created the Federal Deposit Insurance Corporation (FDIC) in 1934, which nationalized the deposit insurance scheme. Creation of schemes continued into the more developed countries in the 1960s and 1970s. The evolution of the World Bank and the International Monetary Fund also gave greater exposure to the concept of the DIS, increasing its popularity with countries wishing the support its financial markets.[171] The effect of the global financial crisis in 2007-2008 caused many countries to re-examine the state of their DIS and also caused countries such as Australia to consider the implementation of a DIS. The system, now known as the Financial Claims System (FCS), was introduced by the Australian Federal government to strengthen the financial marketplace.[172]

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[168] Milena Migliavacca, 'On European Deposit Protection Scheme(s)' in G Chesini et al (ed), *The Business of Banking*, Studies in Banking and Financial Institutions (Palgrave Macmillan, 2017) 169.

[169] See for instance APRA, *Prudential Policy* (2020) Australian Prudential Regulation Authority <https://www.apra.gov.au/prudential-policy>.

[170] Jakub Kerlin, 'Development of Deposit Guarantee Schemes and Their Role in the Financial Safety Net' in *The Role of Deposit Guarantee Schemes as a Financial Safety Net in the European Union*, Palgrave Macmillan Studies in Banking and Financial Institutions (Palgrave Macmillan, 2017) 29.

[171] Ibid 34.

[172] Grant Turner, 'Depositor Protection in Australia' (2011) (December Quarter) *RBA Bulletin* 45, 49.

To support the growing number of countries wishing to either implement a DIS or review the effectiveness of their existing scheme, the International Association of Deposit Insurers in conjunction with the Basel Committee on Banking Supervision developed and issued a set of Core Principles on which all DIS should be based.[173] The first Core Principles were issued in June 2009 and were the basis of the introduction of a number of DIS, or revision of existing systems in response to the GFC. After many learned lessons and extensive review of many DIS across the world, those Core Principles were revised in 2013 and then re-issued.

It is a reasonable assumption that most consumers in the world, but certainly in Australia, deposit money in a banking institution, and it is with that enormity of use and trust that the Core Principles have been developed. It is also with that enormous coverage across the world that these principles have been introduced at this point of the thesis. This chapter has been about ad hoc compensation schemes focused on specific groups or classes of consumers. A DIS is there for most of any countries' citizens. The IADI Core Principles are therefore considered the most appropriate platform upon which to create the framework for a compensation scheme for this country's consumers.

4.9 Chapter Summary

Regardless of the industry and regardless of the regulatory measures to reduce the instance, it appears that companies will fail. There will be creditors who were able to incorporate a security within their contract with the failed company and there will be those who could not. Those who could not and others who were unlucky enough to be in the middle of a contract with the defaulting entity are placed together as unsecured creditors. From that group of unsecured creditors within the industries described in this chapter, protective measures have been put in place specifically for consumers. The aim of this thesis is to consider consumers within all industries.

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[173] International Association of Deposit Insurers, 'IADI Core Principles for Effective Deposit Insurance Systems' (IADI, November 2014) <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf>.

The extensive development of consumer protection policy and the broad network of policy-makers and initiators of legislation, as discussed in Chapter Three, indicate that governments in Australia, the United States of America and the European Union clearly have a significant focus on consumer issues. In any capitalist economy 'consumer-sovereignty' is widely described as the key to the marketplace.[174] The concern that has been shown for consumers within the Stock Exchange industry in all three National legislatures, as outlined in this chapter, is clearly extensive.

It has been important to illustrate, through the extensive detail in this chapter, that those three national bodies have a deep concern for consumers through their policy structures, but have initiated only a limited number of responses to the threat of company insolvency, which are specifically focused. The review has considered why schemes were developed. Stock Exchange schemes were initially developed for the self-preservation of the business of transacting stocks. Government intervention came later, either at the demand of the stock exchanges, or the politicians decided to act based on the theory of 'public interest'.

The varying regulatory instruments that were implemented in an attempt to stop companies failing were not successful, and although those instruments were strengthened through compulsory licencing arrangements, a compulsory compensation scheme was the ultimate solution to maintain consumer confidence. This was also the ultimate outcome of the concern for home renovators and homebuilders who have suffered under the failure of building companies in all states of Australia. The registration of builders and other regulatory controls were not able to reduce concerns for the consumer, so compulsory insurance schemes were introduced at the State government level.

Compensation for employees of companies entering insolvency was introduced only after failures of significant companies. It must be noted that all schemes discussed were introduced only after a failure had occurred. The employee scheme was introduced at the Federal Government level, similar to

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[174] Bernard Hodgson, 'Democratic Agency and the Market Machine' (2012) 108 *Journal of Business Ethics* 3, 5; Gretchen Larson and Rob Lawson, 'Consumer Rights: An Assessment of Justice' (2013) 112 *Journal of Business Ethics* 515, 516; M. Joseph Sirgy and Chenting Su, 'The Ethics of Consumer Sovereignty in an Age of High Tech' (2000) 28 *Journal of Business Ethics* 1.

the Stock Exchange scheme. The Travel Industry protection scheme in the EU is another example of a small class of consumers being protected when a company ceases to trade. The consumer protection policies of the Australian Government recognise that detriment may be caused to consumers, and they offer guidance as to how that detriment could either be mitigated or how the consumer could be recompensed. It has been clearly shown that all classes of consumers can be caused detriment when a company ceases to trade. Only a select number of classes of consumers have benefited from a closing of the regulatory gap. It is evident that command-and-control regulatory instruments, as presented in this chapter, have been the most widely used. From all of the regulatory instruments presented in this chapter it is clear that the only way to protect a consumer from the insolvency of an entity upon which they rely is to create a compensation scheme similar in nature to the Stock Exchange fund and the Deposit Insurance Scheme. It appears that no regulatory instrument that purports to manage the activities of product and service suppliers and their associated industries will actually stop an entity from failing.

Taking the next step to close the regulatory gap for consumers holding Active Entitlements, Chapter Five will present a framework for a consumer compensation scheme based upon the Core Principles developed by the IADI that have been the basis for deposit insurance schemes across the world.

The proposition in this section 4.9 has been analogous to the first element of step five of the six-step approach to consumer policy issues[175] where it is recommended to evaluate options. The examples in this chapter have provided several options but one style of option appears to be appropriate. The next chapter will select that policy option, which is the second element in step 5.

[175] Policy and Research Advisory Committee of the Standing Committee of Officials of Consumer Affairs, above n 144.

FIVE

THE AUSTRALIAN CONSUMER COMPENSATION SCHEME

5.1 Introduction

An observation that is clear from the various schemes described in Chapter Four is that the most heavily regulated fields of business in Australia, and the world, also provide the customers of those businesses with a safety net, or compensatory scheme should one of those businesses fail. As can be seen from the National Guarantee Fund implemented in Australia, the Securities Investor Protection Corporation (SIPC) in the USA, Travel Provider Insurance in the EU, and Employee Compensatory schemes in all three jurisdictions as examples, implementation of regulation at the federal level of government would provide consistent protection for consumers across the country. It was also noted that for governments to make more knowledgeable and responsive decisions, more information about the issue must be made available. Several sections below call for more information to be made available so that specific portions of these recommendations can provide clarity as to the overall outcomes.

The large majority of businesses in Australia are regulated only by the *Corporations Act 2001* (Cth),[1] which, for those businesses not providing financial services, is very little regulation compared to those regulated by APRA[2] such as banks, insurers or stock brokers. The customers of those largely unregulated companies are provided no safety net should one of those businesses fail.

When a business fails and a consumer holds any of the Active Entitlements, there may be various safety nets that could be implemented to resolve the consumer issue depending upon the Active Entitlement(s) held. It is, however, the aim of this chapter to outline a compensation scheme that will resolve any

[1] Michael T Schaper, 'A brief history of small business in Australia, 1970-2010' (2014) 3 *Journal of Entrepreneurship and Public Policy* 222.
[2] Australian Prudential Regulation Authority.

and all of the consumer concerns should a company fail whilst the consumer holds Active Entitlements.

The most activity with regards to compensation schemes was in 2008 when the Global Financial Crisis (GFC) caused most economies worldwide to concern themselves with securing their banking systems.[3] The International Association of Deposit Insurers (IADI) developed a prescribed list of Core Principles[4] that should be the basis of a banking compensation scheme. Whilst many countries already had a safety net in place, the IADI Core Principles were developed to strengthen those safety net systems in the wake of the GFC. The current list of Core Principles was revised in 2013[5] and, given the strong regulatory nature of those Core Principles, will be used as guidelines for a new Australian Consumer Compensation Scheme (ACCS). These Core Principles provide an overarching guide to the nature of the ACCS, its aims and outcomes with some suggestions as to how it may be structured. This is not intended to necessarily be a template for legislation but more a guide that a committee should begin with, to then define the ACCS in its full form, including the associated legislation. The Core Principles naturally use language that is reflective of the banking industry. Each Core Principle will be analysed and a new version will be defined, reflecting a more commercial approach applicable to any industry.

The implementation of such a scheme in Australia would have some impact on every business and that will be analysed both at the individual Core Principle level as well as overall.

5.2 Core Principle 1 – Public Policy Objectives

> The principal public policy objectives for deposit insurance systems are to protect depositors and contribute to financial stability. These objectives should be formally specified and publicly disclosed. The

[3] Deniz Anginer, Asli Demirguc-Kunt and Min Zhu, 'How does deposit insurance affect bank risk? Evidence from the recent crisis' (2014) 48 *Journal of Banking and Finance* 312.

[4] International Association of Deposit Insurers, 'IADI Core Principles for Effective Deposit Insurance Systems' (IADI, November 2014) <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf>.

[5] Ibid.

> design of the deposit insurance system should reflect the system's public policy objectives. [6]

The very nature of a scheme that would protect all consumers within Australia implies that it must be initiated at the highest level of government. The Federal government must be the initiators and developers of the scheme. Federal parliament must pass legislation that would formally acknowledge the objectives of the scheme as well as provide the clear outline and details of the scheme to support those objectives. By stating the objectives within the legislation the public will become better informed of the role this legislation will play in the community.[7] From a regulatory theory perspective the main reason why a government would initiate such a scheme would be for the 'public interest'. [8] It would be most likely that business would not lobby the government for such a scheme and under these circumstances the capture theory would not apply. Whilst some consumer groups may wish for such a scheme to be implemented, it is also very unlikely that consumers would band together to rally in the streets to demand such a scheme, as Reich and Bourgoignie suggest.[9]

The expanded criteria of this core principle also recommends that a review process be adopted to ensure that the scheme, once implemented, continues to meet the objectives as prescribed in the legislation. The criteria for such a review will be discussed after the Core Principles.

Whilst the main objective of this scheme will be to protect consumers when a company ceases to trade, there may be other objectives that could be included formally in the core principle and will be discussed further below, however initially a restated Core Principle 1 should read: The principal public policy objective for the Australian Consumer Compensation Scheme is to protect consumers who hold Active Entitlements at the time a company ceases to trade. These objectives should be formally specified and publicly

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[6] International Association of Deposit Insurers, above n 2, 18.

[7] Djurdjica Ognjenovic, 'Key Design Features of an Explicit DIS' in *Deposit Insurance Schemes*, Palgrave Macmillan Studies in Banking and Financial Institutions (Palgrave Macmillan, 2017) 49, 52.

[8] See 2.3.

[9] See 2.5.2.

disclosed. The design of the scheme should reflect the public policy objectives.

5.3 Core Principle 2 – Mandate and Powers

> The mandate and powers of the deposit insurer should support the public policy objectives and be clearly defined and formally specified in legislation.[10]

The mandate will provide greater clarity of the objectives by specifying what the scheme, and scheme manager, will have the power to do. In the case of the Deposit Insurance Scheme (DIS), this core principle offered a scheme to operate at one of four levels.[11] The first level provides for the scheme to simply pay out insured deposits if the failed bank fell short. This is known as a 'paybox' scheme.[12] The second level, known as 'paybox plus', advocates that the scheme manager may also be involved in the resolution of the failed bank. That level also provides the scheme manager with the power to be actively involved in monitoring the included banks. The third and fourth levels provide the scheme manager with further powers to be involved with the regulation of the bank to ensure the bank either minimises losses or reduces risk. For the ACCS, at this stage it is proposed that it would as act in a 'paybox' role and have funds available to pay consumers who were financially disadvantaged by the failure of a company. Resolution of the failed company would be subject to the current insolvency process.[13]The trigger to begin the payments will be discussed further below.

The powers of the scheme and the scheme manager would include[14], but not be limited to: assessing and collecting premiums, levies or other charges; reimbursing consumers; obtaining information from companies to support

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[10] International Association of Deposit Insurers, above n 2, 19.
[11] Djurdjica Ognjenovic, above n 4, 54.
[12] Asli Demirguc-Kunt, Edward J. Kane and Luc Laeven, 'Deposit Insurance Database' (International Monetary Fund, July 2014), 12.
[13] *Corporations Act 2001* (Cth) Chapter 5.
[14] International Association of Deposit Insurers, above n 2, 19.

these powers[15]; and to set budgets, and define polices, systems and practices. The revised Core Principle 2 should read: The mandate and powers of the Australian Consumer Compensation Scheme and the scheme manager should support the public policy objectives and be clearly defined and formally specified in legislation.

5.4 Core Principle 3 - Governance

> The deposit insurer should be operationally independent, well governed, transparent, accountable, and insulated from external interference.[16]

The regulatory theory of command-and-control with direct regulation by the legislature raised many concerns and has led to the creation of agencies to perform the regulatory management of legislation.[17]An essential criterion of this core principle is that the deposit insurer, or scheme manager, is independent from the government, which re-enforces the position of that regulatory theory. The scheme manager should be very closely aligned with ASIC due to the nature of the information required to perform the necessary functions as stated in Core Principle 2. As an agency, the scheme manager would also therefore be accountable to a higher authority.[18] The scheme manager must be provided the capacity to support its operational independence and fulfil its mandate. Clearly the agency in Australia would be subject to the requirements of the *Corporations Act 2001* (Cth) as well as being transparent and unbiased in its approach to the delivery of its operation. The DIS core principle does not specify directly how the scheme manager would be structured, however a board would be required to oversee the scheme strategy and operations. It is suggested that representatives from various industries as well as consumer groups may be appropriate members of the board given that the scheme supports consumers should a company in

[15] It will be seen in the 'Sources of Funds' core principle that information will be required from companies to enable assessment the required funds overall and then to calculate levies.
[16] International Association of Deposit Insurers, above n 2, 21.
[17] See 2.4.1.
[18] International Association of Deposit Insurers, above n 2, 21.

industry fail. The process by which members of the board are selected, the terms of tenure and remuneration should all be transparent.[19]The scheme manager must be subject to both internal and external audit on a regular basis. The governance structure should be specified in the legislation in sufficient detail to avoid ambiguity and misunderstanding.[20]The revised Core Principle 3 should read: The ACCS manager should be operationally independent, well governed, transparent, accountable, and insulated from external interference.

5.5 Core Principle 4 - Relationships With Other Safety-Net Participants

> In order to protect depositors and contribute to financial stability, there should be a formal and comprehensive framework in place for the close coordination of activities and information sharing, on an ongoing basis, between the deposit insurer and other financial safety-net participants.[21]

The essence of this core principle is to ensure that the scheme manager has explicit access to information required from other agencies or government bodies to perform the functions required. All necessary legislation pertaining to other agencies should reflect that explicit access. Furthermore, the following core principle relates to cross-border issues and, if not immediately, legislation should also reflect potential needs to exchange information with other countries. The revised Core Principle 4 should read: In order to ensure the ACCS manager is unobstructed in its performance, there should be a formal and comprehensive framework in place for the close coordination of activities and information sharing, on an ongoing basis, between the ACCS manager and other government agencies, both domestic and international.

5.6 Core Principle 5 – Cross-Border Issues

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[19] Ibid.
[20] Djurdjica Ognjenovic, above n 4, 60.
[21] International Association of Deposit Insurers, above n 2, 23.

> Where there is a material presence of foreign banks in a jurisdiction, formal information sharing and coordination arrangements should be in place among deposit insurers in relevant jurisdictions.[22]

As will be seen under the core principle of Membership, all companies and sole traders within Australia will be included under the ACCS. Foreign companies that wish to operate in Australia must have an Australian company presence, and would therefore be covered. Consumers who deal with companies in another country, most commonly over the internet, which do not have an Australian office, will not necessarily be covered under the ACCS. For the purpose of this core principle, if other countries were to adopt a similar Consumer Compensation Scheme, there should be the opportunity for sharing of information and the potential for coverage of consumers who deal with companies based in those external countries. This core principle provides for the government and the scheme manager to develop multi-lateral agreements to enable that sharing of information and the coverage of consumers across borders. The revised Core Principle 5 should read: Where there is a Consumer Compensation Scheme operating in another jurisdiction, formal information sharing and coordination arrangements should be in place between Australia and the relevant jurisdictions to ensure extended consumer protection.

5.7 Core Principle 6 – Membership

> Membership in a deposit insurance system should be compulsory for all banks.[23]

It is intended that all Australian companies (including partnerships and trusts), other than those already covered under another compensation scheme, would be subject to this core principle. It is well known that many trading entities are not companies under the *Corporations Act 2001* (Cth) but are known as sole

[22] International Association of Deposit Insurers, above n 2, 24.
[23] International Association of Deposit Insurers, above n 2, 26; known as IADI Core Principle 7.

traders.[24] Including sole traders under this core principle would be subject to further debate. However, consumers should have the opportunity to be aware of which entities, including sole traders, are covered under the ACCS via a simple internet look-up facility. There would be significant market advantage by having a trading entity covered under the ACCS, and there may be potential for an opt-in option for sole traders, subject to the next two principles of Coverage and Sources of Funds.

Banks in all jurisdictions are subject to comprehensive prudential regulation and supervision.[25]Whilst membership of the DIS should be compulsory for all banks, there may be some eligibility criteria, based on prudential standards, that each bank must attain before membership is granted.[26] Eligibility criteria of a different kind would be required for membership of the ACCS. The eligibility of trading entities should be based on their liabilities under the ACL.[27] The term *supplier* as defined in the ACL[28] refers to an entity that supplies, by way of sale, goods or services. In usual circumstances the supplier is the entity that interacts with the consumer. Again, in usual circumstances, a manufacturer provides the goods to the supplier. The manufacturer is defined in the ACL as "a person who grows, extracts, produces, processes or assembles goods"[29] or more generally as "a person who holds himself or herself out to the public as the manufacturer of goods".[30] It is also important to note that the term manufacturer also includes[31] "a person who imports goods into Australia if: (i) the person is not the manufacturer of the goods; and (ii) at the time of the importation, the manufacturer of the goods does not have a place of business in Australia." The issue of liabilities came under scrutiny in the matter of *Morphy v Beaufort Townsville Pty Ltd* [2018] VCAT 1520. In this case Mrs Morphy purchased a motor vehicle from the dealership owned by Beaufort Townsville Pty Ltd

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[24] ATO, *Sole Trader* (10 November 2016) Australian Tax Office < https://www.ato.gov.au/Business/Starting-your-own-business/Before-you-get-started/Choosing-your-business-structure/Sole-trader/>.
[25] International Association of Deposit Insurers, above n 2, 26.
[26] Djurdjica Ognjenovic, above n 4, 62.
[27] *Competition and Consumer Act 2010* (Cth) sch 2 ch 5 pt 5-4 div 1-2.
[28] *Competition and Consumer Act 2010* (Cth) sch 2 s3.
[29] *Competition and Consumer Act 2010* (Cth) sch 2 s7(1)(a).
[30] *Competition and Consumer Act 2010* (Cth) sch 2 s7(1)(b).
[31] *Competition and Consumer Act 2010* (Cth) sch 2 s7(1)(e).

(Beaufort). The vehicle was imported into Australia by Jaguar Land Rover Australia Pty Ltd (JLRA) and provided to Beaufort for sale to consumers. The purchased vehicle suffered a number of reliability problems causing Mrs Morphy to be without use of the vehicle for 55 days within a period of seven months.[32] Mrs Morphy relied upon sections 259 and 260 of the ACL[33] as the vehicle has suffered major failure and sought a full refund and recovery of costs associated with the loss of use of the vehicle. Initially, Mrs Morphy had taken action against Beaufort, but shortly afterwards Beaufort joined JLRA and "sought indemnity via a cross action pursuant to s 274 of the *ACL"*.[34] JLRA subsequently became second respondent to Mrs Morphy's action. The vehicle was originally manufactured by Jaguar Land Rover (UK) but, as that entity did not have an office in Australia, JLRA, as the importer, defaulted to be the manufacturer as per ACL s7(1)(e).[35] The court found that the vehicle had suffered a major failure and was not of suitable durability pursuant to ACL s54(2)(e).[36] It was also found that Mrs Morphy had elected to reject the vehicle before the expiration of the 'rejection period'[37] and granted relief to Mrs Morphy from Beaufort. Beaufort then sought relief itself from JLRA pursuant to ACL s274, which allows suppliers to seek indemnity from manufacturers.[38] The court accepted that JLRA was the manufacturer and should therefore indemnify Beaufort.[39] Based on the events in this case, it would be reasonable to assume that suppliers have agreements with manufacturers such that any repairs or replacement of goods conducted by the supplier for the benefit of a consumer, subject to the consumer guarantees within the ACL, would be indemnified by the manufacturer.[40] It could therefore be argued that only manufacturers should be included in the membership of the ACCS.

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[32] *Morphy v Beaufort Townsville Pty Ltd* [2018] VCAT 1520 [36].
[33] *Competition and Consumer Act 2010* (Cth) sch 2 ss259-260.
[34] Thomas Cadd, 'Wall Printers That Clog, Luxury And Budget Cars Flogged; The Question Of Jurisdiction And Borders' (2019) 27 *Australian Journal of Competition and Consumer Law* 272, 273.
[35] *Competition and Consumer Act 2010* (Cth) sch 2 s7(1)(e).
[36] *Morphy v Beaufort Townsville Pty Ltd* [2018] VCAT 1520 [72].
[37] *Competition and Consumer Act 2010* (Cth) sch 2 s262; *Nesbit v Porter* [2000] 2 NZLR 465.
[38] *Competition and Consumer Act 2010* (Cth) sch 2 s274.
[39] Thomas Cadd, above n 31, 274.
[40] Also supported by *Mellare v United Pacific Industries Ltd* [2014] NSWSC 1626.

Alternatively however, a supplier may, in many cases, provide goods from a manufacturer and install the goods for a consumer, to the manufacturers' specifications. Should the supplier not follow those specifications there may be resulting concerns for the consumer. This occurred for Ms Li when she engaged a contractor to provide new floorboards at her home. "Less than a month after their installation it became apparent to Ms Li that the flooring was sub-standard, and she experienced significant difficulties including peeling laminate and creaking".[41] It was found that there was not a problem with the actual floorboards from a manufacturing perspective, but from the poor installation process conducted by the supplier.[42] Similar arguments are continuing in the inquiries into the building cladding issues that arose when the external finish to the Grenfell Tower in London burnt in 2017, the cladding of the Lacrosse Building in Melbourne burnt in 2014 and the Neo200 tower fire in Melbourne in 2019. In those instances, whilst the quality of the product may not have been to the correct standard, it remains to be seen if the incorrect product was chosen by a supplier of services.[43] The proportion of liability of the manufacturer and supplier could therefore be in question. However, the manufacturer may not be liable if: there was a representation, or omission, by the supplier that caused the consumer to reject the goods;[44] the goods were damaged after they left the control of the manufacturer;[45] or the supplier charged a price higher than the recommended manufacturers' price which caused the consumer to have higher expectations of the goods.[46] Suppliers could therefore assume some liability from the enforcement of the consumer guarantees within the Australian Consumer Law and therefore should be included as members of the ACCS. Further consideration will be given to the varying liabilities of suppliers and manufacturers at 5.9.

At the same time however, there may also be trading entities that may claim they should not be included due to their size, or perceived importance. The

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[41] Thomas Cadd, 'Fish Tanks, Termites And Dodgy Floorboards' (2018) 26 *Australian Journal of Competition and Consumer Law* 291, 292.
[42] *Andy And Patrick Floor Covering Pty Ltd V Li* [2018] NSWCATAP 172.
[43] Mark Waller, Chris Erfurt and Tara Mulroy, 'Cladding – Who Will Pay?' (2019) 35 *Building and Construction Law* 91.
[44] *Competition and Consumer Act 2010* (Cth) sch 2 s271(2)(a).
[45] *Competition and Consumer Act 2010* (Cth) sch 2 s271(2)(b).
[46] *Competition and Consumer Act 2010* (Cth) sch 2 s271(2)(c).

problem of the 'too big to fail'[47] attitude of some organisations has been exacerbated over many years by the bailout of certain organisations by governments[48] thus creating this moral hazard.[49] For consumers holding Active Entitlements, a bailout of a relevant company would be positive for them. "But the sad reality is that the decision about which companies deserve a bail-out and which companies should join whale oil merchants and abacus makers in the cemetery of dead businesses is entirely arbitrary, dependent only on the political winds in Canberra".[50] This commentary reinforces the fact that lobbyists do have influence with politicians in many different areas, supporting the capture theory.[51]

Similarly, in the USA during the 2008 Global Financial Crisis (GFC), the Federal Government bailed out many industries and individual corporations.[52]Along with a number of finance organisations, the automobile industry faced certain extinction. Chrysler, General Motors and Ford all received government support, allowing the companies to restructure and become more competitive as the effect of foreign imports took its toll.[53]One of the many elements of that government support was the inclusion of a "warranty commitment plan designed to promote consumer confidence in the distressed manufacturers by ensuring the coverage of warranties for cars purchased during the restructuring period".[54]This indicates that there was government concern for the consumer holding an Active Entitlement to a warranty.

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47 Demirguc-Kunt, Kane and Laeven, above n 9, 17.
48 Peter G. Brierley, 'Ending Too-Big-To-Fail: Progress Since the Crisis, the Importance of Loss-Absorbing Capacity and the UK Approach to Resolution' (2017) 18(3) *European Business Organization Law Review* 457, 458.
49 Demirguc-Kunt, Kane and Laeven, above n 9, 17.
50 Chris Berg, 'The bail-outs disease', *Sydney Morning Herald* (Sydney), 1 February 2009.
51 See 2.3.
52 Carlos D Ramirez, 'The $700 Billion Bailout: A Public-Choice Interpretation' (2011) 7 *Review of Law and Economics* 291.
53 Jason R Parnell and Robert W Emerson, 'Bankruptcies and Bailouts: The Continuing Impact of the Financial Crisis on the Franchise Auto Dealer Industry' (2018) 21(2) *University of Pennsylvania Journal of Business Law* 288.
54 Robert Marko, 'The Road Closed: The Inequitable Treatment of Pre-Closing Products Liability Claimants under the Auto Industry Bailout' (2010) 4 *Brooklyn Journal of Corporate, Financial & Commercial Law* 353, 355.

There appears, however, to be unclear policies or frameworks that clearly identify which industries or corporations may be subject to a bail out,[55] thus providing consumers with Active Entitlements with no clear surety of their position. As further examples: although Ansett Airlines was a significant employer, the Australian government of the day decided not to bail out the airline;[56] the UK government bailed out a number of hospitals in 2014;[57] in 2004 Pacific Gas and Electric Company was supported by the Californian government through the bankruptcy process to resume its operations as it provided a service that was important to the health and safety of the citizens.[58] Due to this indiscriminate choice, subject to capture theory, of which companies or industries may be saved by a government backed bail out, the inclusion of all trading entities as members of the ACCS must be compulsory for the protection of consumers.

Compulsory inclusion would most likely bring about the argument of why the mining industry, for instance, should support retail stores. The discussion on that argument will be provided under Sources of Funds below.

The other concern that has been raised within the DIS industry is whether the banks would act in a more reckless manner given that their customers are 'covered' under the DIS.[59] Given the close prudential regulation of the banking and insurance industries the opportunity for reckless behaviour could be seen as slight. However, the General Manager of the Bank for International Settlements at an IADI conference[60] made it clear that "In terms of supervision, supervisors are called upon to be more demanding with banks' corporate governance, internal culture – including at the board level – and risk management, among other things". Given the little supervision of the proposed membership of the ACCS, the need for the ACCS is paramount.

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[55] Shlomit Azgad-Tromer, 'Too Important to Fail: Bankruptcy versus Bailout of Socially Important Non-Financial Institutions' (2017) 7 *Harvard Business Law Review* 159, 163.
[56] Chris Berg, above n 26.
[57] Shlomit Azgad-Tromer, above n 31, 164.
[58] Ibid.
[59] Christos Gortsos, 'Deposit Guarantee Schemes: General aspects and recent institutional and regulatory developments at international and EU level' (Research Paper, April 2016).
[60] Jaime Caruana, 'Post-crisis financial safety net framework: lessons, responses and remaining challenges' (Paper presented at the FSI-IADI Conference on "Bank resolution, crisis management and deposit insurance issues", Basel, 6 December 2016).

The revised Core Principle 6 should read: Membership in the Australian Consumer Compensation Scheme should be compulsory for all companies, partnerships and trusts (any trading entity).

5.8 Core Principle 7 – Coverage

> Policymakers should define clearly the level and scope of deposit coverage. Coverage should be limited, credible and cover the large majority of depositors but leave a substantial amount of deposits exposed to market discipline. Deposit insurance coverage should be consistent with the deposit insurance system's public policy objectives and related design features.[61]

Initial protection for deposit holders in Australia came as a function of the then central bank, the Commonwealth Bank, and was included in the *Banking Act 1945* (Cth). Essentially that protection manifested itself as supervision, which was then handed over to the Reserve Bank of Australia, and subsequently APRA. Included in the *Banking Act 1945* (Cth) was 'depositor preference', which meant that should a bank fail the depositor would have a higher preference than other creditors in the liquidation process.[62] The Global Financial Crisis in 2008 led the Australian government to introduce greater protection with the Financial Claims Scheme[63] that guaranteed bank deposits up to $1M per account holder, per institution. Legislation also included a review of the situation in three years time, and in 2012 the cap was reduced to $250,000 per person, per institution.[64]

Regulation of deposit insurance within the EU began in 1994[65] with an attempt to harmonise the various schemes already in place in member states. Initially the minimum coverage was EUR20,000.[66] During the GFC a number of member states increased that minimum to reassure depositors. At that time

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[61] International Association of Deposit Insurers, above n 2, 27; known as IADI Core Principle 8.
[62] Turner, above n , 49.
[63] *Financial System Legislation Amendment (Financial Claims Scheme and Other Measures) Act 2008* (Cth).
[64] Grant Turner, above n 38.
[65] Directive 94/19/EC.
[66] Angelo Banglioni, 'The Missing Pillar: A European Deposit Insurance' in *The European Banking Union* (Palgrave Macmillan, 2016) , 111.

member states such France, Germany, Austria, Poland, Sweden and Spain all set the maximum to EUR100,000. As at the end of 2013 those maximums remained.[67]

In the USA the first bank failure occurred in 1809 and in 1829 New York became the first state to introduce a form of deposit insurance scheme.[68] Subsequently a number of other individual states introduced similar schemes and in 1933 the Federal Deposit Insurance Corporation was created through legislation to administer a scheme across the federation.[69] The coverage limit was USD250,000 in 2010 and remained at that level at the end of 2013.[70]

The intent of a DIS has been to protect the small depositor, but also the banking system. If all small investors felt their deposit was not safe there may be a 'run' on a bank and there would not be sufficient funds to fulfil all withdrawals, creating uncertainty and disillusionment in the banking system.[71] Each DIS defines which depositors it would cover, generally not covering other banking institutions, investment firms, pension funds, public entities and their own funds. The rationale is that those depositors are more like investors and are therefore subject to their own risk analysis.[72]

The ACCS would utilise the definition of consumer from the Australian Consumer Law to define who, and which goods, would be covered, and definitions within this thesis of Active Entitlements to clarify the extent of coverage. A person (including corporate entities) is taken to be a consumer if they had purchased goods that did not exceed the value of $40,000,[73] or the goods purchased were of a kind used for personal, domestic or household consumption,[74] or "the goods consisted of a vehicle or trailer acquired for use principally in the transport of goods on public roads".[75] Those definitions are qualified such that goods cannot be used for the purpose of re-supply,

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[67] Demirguc-Kunt, Kane and Laeven, above n 9, 34-35.
[68] Federal Deposit Insurance Corporation, *A History of the FDIC 1933-1983* (14 May 2018) FDIC <https://www.fdic.gov/bank/historical/firstfifty/chapter2.pdf>.
[69] Federal Deposit Insurance Corporation, *Deposit Insurance: Fund Management and Risk-Based Deposit Insurance Assessments* (1 October 2019) FDIC <https://www.fdic.gov/bank/historical/crisis/chap5.pdf>.
[70] Demirguc-Kunt, Kane and Laeven, above n 9, 34-35.
[71] Angelo Banglioni, above n 42, 114.
[72] Ibid.
[73] *Competition and Consumer Act 2010* (Cth) sch 2 s3(1)(a)(i).
[74] *Competition and Consumer Act 2010* (Cth) sch 2 s3(1)(b).
[75] *Competition and Consumer Act 2010* (Cth) sch 2 s3(1)(c).

transformation, in manufacturing or repair.[76]Acquisition of services is covered similarly[77] to goods, and all values are subject to further qualification.[78] To be clear, as an example, a company purchasing goods from another company for the purposes of manufacturing a secondary product would not be covered under the ACCS.

Coverage under the ACCS would be extended to goods, as described above, that are subject to either statutory guarantee or express guarantee or warranty.[79] The period of coverage would be until the guarantee or warranty timeframe expires. Also covered would be any deposit paid or part-payments made for a product not yet delivered to the consumer. Lastly, any gift card value not yet redeemed would also be covered. To be clear, it is proposed that there would be no limit on the amount to be covered.

Taking into account the above, Core Principle 7 should read: Policymakers should define clearly the level and scope of ACCS coverage. Coverage should be limited to consumers and goods and services as defined in the Australian Consumer Law. The ACCS coverage should be consistent with the scheme's public policy objectives and related design features.

5.9 Core Principle 8 – Sources And Uses Of Funds

> The deposit insurer should have readily available funds and all funding mechanisms necessary to ensure prompt reimbursement of depositors' claims, including assured liquidity funding arrangements. Responsibility for paying the cost of deposit insurance should be borne by banks.[80]

As the principle clearly indicates, there must be readily available funds to pay claims in the timeframe specified in Core Principle 11 below. The details of this core principle directs the scheme manager to provide the funding on an ex ante basis, where "Ex ante funding is defined as 'the regular collection of

[76] *Competition and Consumer Act 2010* (Cth) sch 2 s3(2).
[77] *Competition and Consumer Act 2010* (Cth) sch 2 s3(3).
[78] *Competition and Consumer Act 2010* (Cth) sch 2 s3(4)-(9).
[79] *Competition and Consumer Act 2010* (Cth) sch 2 ss51-63.
[80] International Association of Deposit Insurers, above n 2, 29; known as IADI Core Principle 9.

premiums, with the aim of accumulating a fund to meet future obligations (e.g. reimbursing depositors) and cover the operational and related costs of the deposit insurer.'"[81] Many of the EU DIS funds are funded ex ante.[82] By contrast, the FCS in Australia operates on an ex post basis, that is, uses government funds to pay claims in a timely manner whilst levying banks after the fact to repay the government funded claims.[83] The fundamental reasoning behind the direction to use ex ante funding was 'user pays'.[84]All members of the fund should make contributions because it could be any one of them that fails. The major concern over ex post funding has been that it would only be those left standing that pay for the demise of another.[85]

5.9.1 Fund size

Having determined that a readily available source of funds should be created, the size of the fund must be considered. The IADI published a set of guidelines[86] that considered many factors in determining the size of a fund. Some of those factors included the size of the banking organisation by way of depositors, the total amount of deposits, value of assets and quality of loans, the state of the regulatory regime, the availability and adequacy of liquidity funding, to name a few. These factors assist in determining two elements; the risk of a bank failing, and the potential liability in terms of claims.[87] The potential risks of a bank failing may be measured from the information that regulators regularly receive from the participating banks. ACCS members would not be regulated or provide little information about their risk of insolvency. The banking regulator would also receive detailed information about the number of depositors and the value of the deposits included in the

[81] Djurdjica Ognjenovic, 'Challenges of Funding a DIS' in *Deposit Insurance Schemes*, Palgrave Macmillan Studies in Banking and Financial Institutions (Palgrave Macmillan, 2017) 105, 107.
[82] Demirguc-Kunt, Kane and Laeven, above n 9, 12.
[83] Mary Dowell-Jones and Ross P Buckley, 'Bank levies in Australia: Lessons from Europe' (2016) 27 *Journal of Banking and Finance Law and Practice* 24.
[84] Demirguc-Kunt, Kane and Laeven, above n 9, 12.
[85] Mary Dowell-Jones and Ross P Buckley, above n 59, 25.
[86] IADI, 'Enhanced Guidance for Effective Deposit Insurance Systems: Ex Ante Funding' (IADI, June 2015) <https://www.iadi.org/en/assets/File/Papers/Approved%20Guidance%20Papers/IADI_Enhanced_Guidance_on_Ex-Ante_Funding_June_2015.pdf>, 11.
[87] Djurdjica Ognjenovic, 'Target Funding' in *Deposit Insurance Schemes*, Palgrave Macmillan Studies in Banking and Financial Institutions (Palgrave Macmillan, 2017) 157.

DIS thus providing the scheme manager with capacity to consider potential liabilities in terms of claims. The ACCS would need other information to consider the potential liabilities of claims.

In terms of claims, and based on Core Principle 7 – Coverage, the ACCS could be liable for warranty claims, the value of unpaid deposits and the value of unclaimed gift cards. Information regarding these potential liabilities must be provided on a regular basis to manage the size of the fund. Each member that manufactures and sells products with a warranty must make the ACCS manager aware of; the length of the warranty in years or months, the replacement cost of the product, and the number and date of sales of each product. A warranty provides the consumer with the opportunity to claim from the supplier either a full replacement or repair if necessary, of the goods or services, should there be valid concerns about issues such as suitable quality or fitness for purpose as per the Australian Consumer Law.[88] As stated previously,[89] the value of a warranty within the price of the goods or services would be determined by many factors including the risk of quality and fitness for purpose under certain circumstances. The ACCS manager would consider the information provided and apply risk criteria to determine, over the period of the warranty, the potential liability should the supplier cease to trade. Each member that takes deposits for the delivery of goods and services must regularly inform the ACCS manager of the value of deposits taken with goods or services not yet supplied. Each member that offers the use of gift cards must regularly inform the ACCS manager of; the number of gift cards sold, the value of those gift cards, and the expiry date for each card. The accumulation of this information would then provide the ACCS manager with sufficient information to then determine a target fund size. As an audit note, it is proposed that the information gathered from members could be cross-matched with information received by the Australian Tax Office to validate the information provided by companies in this process.

Determining the fund size could also consider other information possibly already available from previous insolvencies. Moving forward, greater information would be available to review the funding arrangements. The

[88] *Competition and Consumer Act 2010* (Cth) Schedule 2 ss51-63.
[89] See 1.5.

number of insolvencies as a ratio of currently registered trading entities could provide a risk factor. The number of consumers affected by the trading entity ceasing to trade and the potential value of their warranty, or known deposits or known gift cards outstanding could all be used as risk factors to determine the size of the fund. The target size of the fund would clearly be a portion of the total potential liabilities accumulated from warranty, deposit and gift card information. Once the size of the fund can be determined, the amount of the levy can then be considered. Given that the ACCS does not yet exist, one other factor must be considered, and that is the timeframe for the fund to reach the target size or 'time-to-fund'.[90] The EU guidelines suggest a timeframe of no longer than ten years.[91] The shorter the timeframe the greater the initial levy on members of the ACCS.

5.9.2 Sub-schemes

It is appropriate at this point to consider the concern that was posed in Membership above; should the mining industry pay to support retail stores? One of the funding considerations within the IADI guidelines is whether there should be a flat rate applied to each member, or a differential premium system. The differential system considers the risk profiles of each member bank and categorises them based on levels of risk. The higher the risk, the higher the potential premium,[92] which means that lower risk entities don't pay for higher risk entities. As an extension of that concept, the Financial Services Compensation Scheme (FSCS) created in the UK under the *Financial Services and Markets Act 2000* was divided into three sub-schemes; investments, deposits and insurance.[93] The deposits sub-scheme is essentially the DIS as discussed here. The insurance sub-scheme covers insurance policy holders in case of defalcation of an insurance company.[94]

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[90] IADI, above n 62, 11.
[91] Ibid.
[92] Ibid 13.
[93] Oxera Consulting Ltd, 'Description and assessment of the national investor compensation schemes established in accordance with Directive 97/9/EC' (European Commission, January 2005) <https://www.oxera.com/getmedia/8e86101b-ef84-41a6-a5e8-43f205033a51/Investor-compensation-in-the-EU--appendices.pdf.aspx>, 125.
[94] The Australian FCS covers insurance policy holders as well.

The investment scheme is further subdivided based on the type of business for which a member is licenced. Some financial services companies may hold a licence to perform multiple financial services and therefore maybe a member of multiple sub-schemes. Each sub-scheme has a target fund size based on the members' various factors, and levies applied accordingly. Compensation payments that may affect a member of a specific sub-scheme would only be made from that sub-scheme.[95] "The aim is to avoid cross-subsidy between firms engaged in dissimilar business activities; for example, an institutional fund manager is not required to contribute to the costs of paying claims arising from the failure of a retail stockbroker. However, all firms contribute to the scheme's management expenses."[96]

It is proposed the ACCS would implement a similar structure to the sub-schemes as created by the FSCS, answering the concern posed earlier. The Australian Tax Office utilizes a business industry code.[97] ASIC uses the same coding structure in its reporting of companies that have entered external administration, by industry.[98] The business industry code is a structured numeric code that could be utilized to create sub-schemes at a number of levels depending on further examination by the ACCS manager. At its highest level the code can be used to identify businesses that operate in: agriculture; mining; manufacturing; utilities; construction; wholesale trade; retail trade; accommodation and food services; transport, postal and warehousing; information media and telecommunications; financial and insurance services; rental, hiring and real estate services; professional, scientific and technical services; administrative and support services; public administration and safety; education and training; health care and social assistance; arts and recreation services; and other services.[99] At the time of creating a trading entity, either as a company, partnership, trust or sole trader, ASIC could collect this information, provide it to the ACCS manager, and that entity can

[95] Oxera Consulting Ltd, above n 69, 131.
[96] Ibid.
[97] Australian Tax Office, 'Business industry codes' (2017) <https://www.ato.gov.au/uploadedFiles/Content/ITX/downloads/03-2017_Business-industry-codes.pdf>.
[98] ASIC, 'Series 1A: Companies entering external administration by industry, July 2013–November 2019' (ASIC, February 2020) <https://download.asic.gov.au/media/5453301/asic-insolvency-statistics-series-1a-published-february-2020.pdf>.
[99] Australian Tax Office, above n 73.

be included within the appropriate scheme or sub-scheme. If multiple codes are entered for the trading entity it could then participate in multiple sub-schemes and be levied based on the schemes in which it was a member. At the discretion of the board and those who decide on final legislation, that dissection of industries can be quite flexible. The creation of these sub-schemes would also resolve the issue raised at 5.7 as to whether manufacturers and suppliers should both be included as members of the ACCS. As described at 5.9.3, each would be assessed based on the information supplied under the codes for which their business has been classified.

5.9.3 Source of funds

Once the number of schemes, or sub-schemes, has been established, and the target fund size(s) determined, the next process would be to calculate a levy to achieve the target fund. The FSCS has split the levy into two categories; management costs and compensation costs.[100] The base costs consist of a fee to operate the scheme independent of any activity in terms of payment of claims. Base costs will include the generation of levies, receipt and allocation of payments to the appropriate sub-scheme and general management of movements of trading entities into and out of the sub-scheme. On top of the base cost will be a fee to create the target fund itself.[101] The compensation costs would be those costs associated with the assessment of claims when a member causes the trigger event, and the costs associated with the payment of claims. Determination of the various fees would be based on the annual exposure created by the trading entity within the sub-scheme and in proportion with the fund size.[102] Given the dynamic nature of business and the potential impact on cash flow for members, it is proposed that levies should be paid on a quarterly basis. This practice would also provide for efficient financial management within the ACCS manager.[103] The collection of levies to create a compensation fund has been the practice of the National

[100] Oxera Consulting Ltd, above n 69, 131.
[101] Ibid.
[102] Ibid.
[103] Djurdjica Ognjenovic, above n 57, 129.

Guarantee Fund (NGF) in Australia under the management of the Securities Exchanges Guarantee Corporation Limited (SEGC) and in the USA the Securities Investor Protection Corporation (SIPC) is the scheme manager for a similar fund as described in Chapter 4. The EU issued Directive 97/9/EC (the Investment Compensation Scheme Directive) requiring Member states to provide for a similar compensation scheme for stock exchange investors in those member countries. The FSCS was the UK response to that Directive. When the fund target has been reached the ACCS manager would then either reduce the levy or cease to charge a levy until a trigger event occurs. Under this core principle the ACCS manager should also devise a rebate structure for members that decide to leave voluntarily. Remaining liabilities would be accounted for before deciding on a rebate amount, being their share of contributions made, less those expended on compensation payments. Additionally, there must be a formal process in place to allow members of the ACCS to seek a review of their levies to ensure the system is fair and equitable to all members.[104] It is beyond the scope of this thesis to consider the amount of levy that may be charged. Furthermore, there is a significant amount of information to be gathered before any consideration of the levy could be contemplated.

Another element of this Core Principle must be to ensure that the scheme manager is responsible for the sound investment and management of the funds. The SEGC and SIPC hold similar responsibilities. It is expected that prudential standards would apply, ensuring that an appropriate amount of liquidity[105] is available to meet projected compensation payments whilst investments are made in very low risk assets and easily convertible products. It is proposed that legislation would be very prescriptive about investment principles including the requirement for sound planning and management.[106] The SEGC Annual Report from 2019[107] reported the very low-risk appetite of

[104] IADI, 'General Guidance for Developing Differential Premium Systems' (October 2011) <https://www.iadi.org/en/assets/File/Papers/Approved%20Guidance%20Papers/IADI_Diff_prem_paper_FINAL_updated_Oct_31_2011_clean_version.pdf>, 20.
[105] Djurdjica Ognjenovic, above n 4, 88.
[106] Ibid.
[107] Securities Exchanges Guarantee Corporation Limited, 'SEGC Annual Report 2019' (2019) <https://www.segc.com.au/files/SEGC%20ANNUAL%20REPORT%202019.pdf>, 9.

the SEGC board that would be in line with the approach to be taken by the ACCS Manager.

5.9.4 Use of Funds

The primary role of the ACCS fund is to make payments to consumers who have outstanding Active Entitlements should a trading entity become insolvent. This DIS core principle also makes allowance for a specified portion of funds to be available for resolving a potential bank failure. That option is not recommended for the ACCS. Funds however, should be allocated for the education of consumers under the next core principle. This Core Principle 8 should read: The ACCS manager should have readily available funds and all funding mechanisms, including assured liquidity funding arrangements, necessary to ensure prompt payment of valid compensation claims. Responsibility for paying the cost of maintaining the fund and the fund manager should be borne by member trading entities.

5.10 Core Principle 9 – Public Awareness

> In order to protect depositors and contribute to financial stability, it is essential that the public be informed on an ongoing basis about the benefits and limitations of the deposit insurance system.[108]

Ultimately the presence of the ACCS would be of no benefit if the consumer were not aware of the compensation program available for them. The public must be made aware of the features of the ACCS as well as their own responsibilities. The ACCS would not have sufficient information to be proactive in making compensation payments. The consumer would have to make a claim by providing sufficient information to substantiate a valid claim.[109] The public awareness program must therefore, on a regular basis, inform the public about the availability of the ACCS, its benefits and limitations, where and how they may make a claim, and when compensation

[108] International Association of Deposit Insurers, above n 2, 32; known as IADI Core Principle 10.
[109] Ibid.

payments may be expected.[110] The ACCS manager should use various channels of communication including social media, television and radio to ensure the widest coverage of demographics possible.[111] Furthermore, it is proposed that the benefits of the ACCS should dovetail into the promotions developed by ASIC and ACCC when promoting the Australian Consumer Law benefits. Additionally, the Australian Consumer Survey[112] initiated by the Treasury Department should also include a component for the ACCS. That survey includes measuring the understanding by consumers of the benefits of the ACL and similarly the ACCS should be measured to ensure that the public does understand the features of the scheme. The Core Principle 9 should read: In order to ensure complete consumer protection, it is essential that the public be informed on an ongoing basis about the benefits and limitations of the Australian Consumer Compensation Scheme.

5.11 Core Principle 10 - Legal Protection

> The deposit insurer and individuals working both currently and formerly for the deposit insurer in the discharge of its mandate must be protected from liability arising from actions, claims, lawsuits or other proceedings for their decisions, actions or omissions taken in good faith in the normal course of their duties. Legal protection should be defined in legislation.[113]

This core principle is a reminder to ensure that the legislated Acts include legal protection for the entity managing the ACCS as well its employees and any other entity contracted to support the ACCS. Like all other Australian Government agencies, the ACCS manager and the decisions made by individuals on behalf of the ACCS, that affect the consumer or the defaulting trading entity, would be subject to all available interventions under administrative law. Core Principle 10 should read: The ACCS Manager and individuals working both currently and formerly for the ACCS Manager in the

[110] Ibid.
[111] Djurdjica Ognjenovic, above n 4, 69.
[112] Ernst & Young, 'Australian Consumer Survey 2016' (The Treasury, on behalf of Consumer Affairs Australia and New Zealand, 18 May 2016).
[113] International Association of Deposit Insurers, above n 2, 34; known as IADI Core Principle 11.

discharge of its mandate must be protected from liability arising from actions, claims, lawsuits or other proceedings for their decisions, actions or omissions taken in good faith in the normal course of their duties. Legal protection should be defined in legislation.

5.12 Core Principle 11 – Compensation Payments

> The deposit insurance system should reimburse depositors' insured funds promptly, in order to contribute to financial stability. There should be a clear and unequivocal trigger for insured depositor reimbursement.[114]

As the ACCS is a new scheme, consideration must be given to the timing of commencement of claim actioning and payment. The legislators in conjunction with the ACCS board must consider at which point in time the actual compensation function should commence.[115] The collection of funds may take up to ten years, as discussed above, for the fund to reach the target amount. The implementation timeframe, for instance, could be two years from the commencement of the legislation. This timeframe would allow for the development of all policies and procedures within the ACCS Manager as well as the commencement of collection of levies. The legislators may consider providing a government loan guarantee at the commencement of the compensation function should there be a shortfall of funds, with the fund ultimately repaying all loans and becoming self sufficient.[116] Regulators must then consider the 'service level' or what delay there should be before claims would be accepted for processing. The IADI Core Principle declares that compensation should commence within seven working days of the trigger event.[117] The SEGC is regulated by the *Corporations Act 2001* (Cth) and the regulations[118] state that the SEGC may publish details of the insolvent member and the applicable period in which claimants may lodge a claim. The

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[114] International Association of Deposit Insurers, above n 2, 39; known as IADI Core Principle 15.
[115] Ibid.
[116] Djurdjica Ognjenovic, above n 4, 128.
[117] International Association of Deposit Insurers, above n 2, 39.
[118] *Corporations Regulations 2001* (Cth) 7.5.56 (4).

FSCS in the UK adhere to the IADI requirement and provide a seven-day payout.[119] The ACCS should be required to notify consumers in an appropriate fashion about the trigger event and the timeframe for claims. It is proposed that claims maybe lodged with the ACCS immediately a trigger event is published.

5.12.1 Trigger Event

As described at 3.6.3, there are a number of possible avenues a company might take when it is either on the verge of insolvency or legally insolvent. The members of the company may opt to enter voluntary administration.[120] The appointed administrator, in conjunction with creditors, could then restructure the company and continue its operations. There may be a Deed of Company Arrangement (DOCA) struck with the creditors to allow the company more time to meet its debts and continue trading.[121] The DOCA, however, may provide for the release of the company from certain debts, which may include those of unsecured creditors such as consumers holding Active Entitlements.[122] This may cause a trigger event. The company may be wound up either by a court order, or voluntarily. Either of these events would instigate the liquidation process causing a trigger event. The ACCS in conjunction with ASIC would consider the progress of any external administration and declare a trigger event should the holders of Active Entitlements be considered to not be able to claim their entitlements from the entity involved. The ACCS must then publish the details of the company involved, notifying the consumers that their claims would be accepted for consideration. It is proposed that there should be a three-month window, from the date of publication, for consumers to claim their Active Entitlements. For warranty holders, the window for claims would be the latest of three months past the end of their warranty period. The claimant would be required to provide proof of purchase of the goods or services for a claim to be evaluated. For claims against the warranty of goods

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[119] FSCS, *Our Mission and Strategy* (2020) Financial Services Compensation Scheme <https://www.fscs.org.uk/about-us/mission-and-strategy/>.
[120] *Corporations Act 2001* (Cth) s436A.
[121] *Corporations Act 2001* (Cth) s439C.
[122] *Hamilton v National Australia Bank Ltd* (1996) 66 FCR 12, 38.

or services it is proposed that the ACCS would engage experts in the field of the product or service to evaluate the warranty claim. Core Principle 11 should therefore read: The ACCS should compensate consumers promptly upon declaration of a trigger event. There should be a clear and unequivocal trigger for compensation to occur.

5.12.2 Voluntary Liquidation

A small but separate issue, that could also instigate the situation of consumers with active entitlements losing the benefit of those entitlements, occurs when a company chooses to enter into voluntary liquidation.

'A company may be wound up voluntarily if the company so resolves by special resolution'.[123] The corporate state and corporate powers of the company continue until it is deregistered.[124] A company can voluntarily deregister under certain circumstances, one of which is s601AA(2)(e)[125] , when the company has no outstanding liabilities.

Under the financial reporting requirements of the *Corporations Act 2001* (Cth) Part 2M.3, most small companies are not required to prepare annual reports.[126] Under s45A(2) *Corporations Act 2001* (Cth) a company is classed as a small company if it satisfies any two of three criteria: (1) the financial year turnover is less than $25M, (2) gross assets for the financial year are less than $12.5M, (3) the number of employees at the end of the financial year was less than 50.

Information from the Australian Bureau of Statistics[127] indicated that "Of the 2,238,299 actively trading businesses operating at the end of 2016-17, most (98% or 2,085,729) had annual turnover of less than $2m." Furthermore:

- There were 868,248 (38.8%) employing businesses and 1,370,051 (61.2%) non-employing businesses at the end of 2016-17.

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123 *Corporations Act 2001* (Cth) s491(1).
124 *Corporations Act 2001* (Cth) s493.
125 *Corporations Act 2001* (Cth).
126 *Corporations Act 2001* (Cth) s292(2).
127 Australian Bureau of Statistics, *8165.0 - Counts of Australian Businesses, including Entries and Exits, Jun 2013 to Jun 2017* (20 February 2018) <http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/8165.0Main+Features1Jun%202013%20to%20Jun%202017?OpenDocument>.

- Most employing businesses (70.1% or 608,733) at the end of 2016-17 employed between 1 and 4 people whilst 0.5% (3,915) of employing businesses employed more than 200 people.

These statistics alone would indicate that the large majority of businesses operating in Australia are small businesses and highly likely not required to produce annual reports, and neither are they required to comply with any accounting standards.[128]

Standard AASB 137, produced by the Australian Accounting Standards Board, refers primarily to Provisions, Contingent Liabilities and Contingent Assets. Article 13(a) provides that:[129]

> provisions – which are recognised as liabilities (assuming that a reliable estimate can be made) because they are present obligations and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligations;

It should follow then that any company that produces goods (or services) must provide minimum warranties under the ACL. There should, under AASB 137 13(a), be some recognition of that liability in the company books.

However, if most small companies are not required to adhere to any accounting standards, and the liabilities are a checking point before deregistration, it follows that any small company could voluntarily liquidate, notate zero liabilities and deregister whilst consumers are holding an unexpired product warranty.

This situation could constitute a trigger event and, as such, the ACCS could also integrate checks and balances to ensure there are no liabilities left (consumers with active entitlements) before a company voluntarily retires with their levies returned.

5.13 Core Principle 12 – Recoveries

> The deposit insurer should have, by law, the right to recover its claims in accordance with the statutory creditor hierarchy.[130]

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[128] *Corporations Act 2001* (Cth) s296(1A).
[129] Australian Accounting Standards Board, *Pronouncements*, <http://www.aasb.gov.au/admin/file/content105/c9/AASB137_08-15.pdf>.
[130] International Association of Deposit Insurers, above n 2, 41; known as IADI Core Principle 16.

The liquidation process for a company could take a long period of time. The compensatory regime of the ACCS intends to compensate the consumer within a short space of time, upon the declaration of a trigger event. It is proposed that the laws prescribing the liquidation process, *Corporations Act 2001* (Cth), be changed to allow the ACCS Manager to stand in the shoes of those consumers who have been compensated and participate in the liquidation process as an unsecured creditor for the total sum paid at the time of liquidation proceedings. The claim by the ACCS Manager would stand as a provable debt.[131] This proposition has the same effect of the original IADI Core Principle 16.[132] Core Principle 12 should read: The ACCS Manager should have, by law, the right to recover its claims in accordance with the statutory creditor payment hierarchy.

5.14 Core Principle 13 - Assessment of Compliance[133]

Once the ACCS has been implemented, it is proposed that a review be undertaken on a regular basis to assess the compliance of the ACCS with the Core Principles prescribed above as well as the specific legislation enacted. The assessment should firstly consider the broader economic and legislative environment to ensure that policy objectives remain valid. The more detailed assessment should then review all components of the ACCS against essential criteria for each of the Core Principles. Ideally conducted by an independent third party, "a fully objective assessment of compliance with the Core Principles should be performed by suitably qualified parties who bring varied perspectives to the process".[134] It would also be envisaged that, as other countries begin to implement their own Consumer Compensation Scheme, comparisons could be made with other systems to continue to provide the most efficient and effective scheme for Australian consumers. Whilst the assessment of compliance is not listed as a core principle by the IADI it is suggested that this function should be an integral component of the

131 *Corporations Act 2001* (Cth) s553.
132 International Association of Deposit Insurers, above n 2, 41; known as IADI Core Principle 16.
133 International Association of Deposit Insurers, above n 2, 42.
134 Ibid 44.

compensation scheme and should therefore be included as a core principle of the ACCS. Core Principle 13 should read: A regular review of the compensation scheme should be completed, at least bi-annually, by an independent third party to ensure that policy objectives remain valid and the scheme continues to meet those objectives as well as being the most effective and efficient scheme possible. This Principle fulfills step six of the six-step approach to consumer policy issues[135]by including a policy review process to evaluate the effectiveness of the policy.

5.15 Chapter Summary

> Consumer guarantees are at the core of consumer trust and confidence. Consumers need to know that the products they purchase will be safe, lasting and without faults, and that services will be fit for purpose and provided with due care and skill. Consumers also need to know that the representations made about the goods and services they purchase are correct, and that they have effective options for redress where those goods or services fail to meet the consumer guarantees.[136]

The Australian Consumer Laws do provide a comprehensive regulatory 'guarantee' that suppliers and manufacturers should observe, and if not observed, provide a system of redress for affected consumers. This system and suite of laws does provide consumers with a level of trust and confidence in the Australian marketplace. However, a system of redress does not currently exist should the supplier or manufacturer concerned, cease to trade. It was shown in Chapter Four that in a number of selected industries in Australia, and similarly in the European Union and the United States of America, compensation schemes do exist for that situation. All stockbrokers,

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135 Policy and Research Advisory Committee of the Standing Committee of Officials of Consumer Affairs, 'Consumer policy in Australia: A companion to the OECD Consumer Policy Toolkit' (March 2011) <https://consumerlaw.gov.au/sites/consumer/files/2015/09/Companion_to_OECD_Toolkit.pdf >.

136 Gerard Brody et al, 'Response to: Australian Consumer Law Review: Clarification, simplification and modernisation of the consumer guarantee framework – Consultation RIS' (Consumer Action Law Centre, 23 April 2018).

as members of the Australian Stock Exchange, contribute to the National Guarantee Fund. Should a broker be holding funds of a consumer, and then enter into liquidation, the consumer would be compensated by the National Guarantee Fund. The SIPC in the USA provides the same compensatory mechanism, as do schemes in each of the Member states of the EU. In all Australian states there is a compulsory insurance scheme that consumers, who enter building contracts for a certain minimum value, must subscribe to, in case the builder they are dealing with goes into liquidation. In Australia, USA and EU there are compensation schemes created specifically for employees of companies that may enter into liquidation. These schemes compensate the employees for any entitlements earned but not provided in full by the defaulting company. In Australia, only about 25% of the population deal on the stock market. Not everyone enters into building contracts. Most people are employees and most people deposit funds into a bank and almost every country has a Deposit Insurance Scheme.[137] It is without doubt that at a minimum, every person over the age of 16 is a consumer. Consumers can hold Active Entitlements such as a product or service warranty, the outstanding delivery of a product where a deposit has been paid, or the value of gift cards yet to be spent. These Active Entitlements are generally without value should the entity that has provided those entitlements cease to trade. Currently, there is no scheme in place to compensate consumers in that situation.

In Chapter 2 we learned that social harm could be sub-categorised, and one of those categories was financial and economic harm.[138] It was shown that this category of harm could be caused by direct actions such as fraud, theft or destruction of private property. Financial or economic harm could also be caused by an indirect action such as a change in the taxation system, a pandemic, price-fixing via a cartel or, in the case of this thesis, a company ceasing to trade.[139] All of those actions pose a risk to society. Haines[140]

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137 Demirguc-Kunt, Kane and Laeven, above n 9, 17.
138 Paddy Hillyard and Steve Tombs, 'From 'crime' to social harm?' (2007) 48(1-2) *Crime, Law and Social Change* 9.
139 Ibid.
140 Fiona Haines, 'Regulation and risk' in Peter Drahos (ed), *Regulatory theory: Foundations and applications* (ANU Press, 2017), 183.

classified these risks as actuarial, sociocultural or political. An actuarial risk refers to unwanted external events, sociocultural risks can be associated with an event that may change the collective health or social order of society, and political risk can be a threat to the legitimacy of the government of the day.[141] Regulatory measures to address each of these risks would come in different forms. We have seen that to resolve the issue within the Stock Exchange industry, fidelity funds were developed. A compulsory insurance scheme in all states of Australia eased the risk of customers not having their houses completed, and in the USA, EU and Australia regulatory systems were put in place to mitigate the risk of employees not receiving their earned benefits. These regulatory responses were the result of actuarial or sociocultural risks. The decision to regulate at the government level would have been contemplated as a political risk.[142] This was most likely due to the fact that the significant capacity of regulation to reduce risk is also seen as a regulatory burden.[143] As mentioned earlier, the regulatory systems put in place in the examples shown in Chapter 4 were in response to an individual significant event. The event at the time, and a somewhat timely response by the government of the day limited the vision of what regulatory burden there may have been, as the benefit was most clear at the time and of more focus by the public.[144] If the ACCS, this regulatory response, were to be introduced without the political benefit of a significant negative event, the regulatory burden could be well highlighted. It should also be understood that there is a significant amount of information unavailable to this thesis in any form to make any judgment with regards to the cost that may be placed directly onto an individual member of the scheme. There is also insufficient information to complete the Regulatory Burden Measurement as defined under the website for the Department of Prime Minister and Cabinet.[145]

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[141] Ibid.
[142] Ibid, 185.
[143] Ibid, 182.
[144] Michael E Levine and Jennifer L Forrence, 'Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis' (1990) 6 *Journal of Law, Economics, & Organization* 167.
[145] Department of Prime Minister and Cabinet, *Regulatory Burden Measurement* Department of Prime Minister and Cabinet <https://www.pmc.gov.au/regulation/guidance-policymakers/regulatory-burden-measurement>.

This Chapter has utilised the Core Principles developed by the International Association of Deposit Insurers as a framework to develop a Consumer Compensation Scheme for the benefit of the Australian consumer. The banking system is a major economic function for any country and therefore the effectiveness of its compensation scheme would be of utmost importance to ensure there is not a run on the banking system should a bank fail. The IADI Core Principles are also used by the International Monetary Fund and the World Bank to assess any jurisdiction's Deposit Insurance Scheme.[146] It is with those credentials that these Core Principles are used as the basis of this Chapter and the development of the Australian Consumer Compensation Scheme. Chapter Six will provide a review of the developments within this thesis.

[146] International Association of Deposit Insurers, above n 2, 5.

SIX

CONCLUSIONS & RECOMMENDATIONS

6.1 Introduction

A 2019 news article[1] reminds us of the topic of this thesis. A caravan retailer located north of Brisbane "went belly up in March". The administrators "estimates that unsecured creditors, including trade creditors, suppliers and customers, are owed more than $2.9 million but are unlikely to see a cent". In Australia, the USA and the EU, the creditors that manage to secure their contracts with a defaulting company are likely to receive compensation.[2] Trade creditors that were not able to secure their contracts still had the opportunity to negotiate the final terms of the contract and pricing and perhaps alleviate some of the risk. Consumers do not have that opportunity or the tools to investigate a company before dealing with them.[3] These consumers therefore should be protected when a company ceases to trade.

Protecting the consumer holding active entitlements when a company ceases to trade: A legal analysis.

The research undertaken for this thesis has exposed an extensive array of policies, Senate committees, Ministerial committees and other focus and law review groups that are all in a position of potentially protecting consumers in the marketplace. There are, of course, clear guidelines at many levels that direct those various groups to evaluate situations that may cause consumers detriment, and then to determine whether protection is required, and, if so, in what form. The most significant current form of protection comes from the Australian Consumer Law and the embodied product guarantees.[4]

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[1] Glenn Norris, 'Unhappy Campers', *City Beat, Courier-Mail* (Brisbane), 6 April 2019, 53.
[2] Stephanie Ben-Ishai & Stephen J. Lubben, Involuntary Creditors and Corporate Bankruptcy (2012) 45 *University of British Columbia Law Review*, 253.
[3] Ibid.
[4] *Competition and Consumer Act 2010* (Cth) Schedule 2.

Separately, it has been shown that the roadmap for a company that finds itself in financial difficulty is reasonably straightforward in Australia. Without the entrepreneurial buyout from a wealthy benefactor, that company would see itself pass through the insolvency process, as prescribed by the *Corporations Act 2001* (Cth) and a sole trader via the *Bankruptcy Act 1966* (Cth).

Not unreasonably, these two regulated systems, consumer protection and insolvency, never cross paths. However, any consumer who has some active entitlements at the time of a company's insolvency, becomes by default an unsecured creditor within the insolvency process. Any consumer protection measures that may have been in place immediately stop the moment the insolvency process begins.

In some very limited circumstances, there are schemes and mechanisms that have been legislated to assist consumers or other groups who have been caused detriment by a company entering insolvency, and those consumers or groups can be compensated.

The following sections review those research findings.

6.2 Consumer Protection

Some observers and consumer law authors such as Bourgoigne[5] and Reich[6] have suggested that consumers should gather together to bargain with suppliers to balance the power at the negotiating table. Others, including Mises,[7] would suggest that the consumer was already sovereign:

> The direction of all economic affairs in the market society is a task of the entrepreneurs. They are bound to obey unconditionally the captain's orders. The captain is the consumer. Neither the entrepreneurs nor the farmers nor the capitalists determine what has to be produced. The consumers do that. They determine precisely what should be produced, in what quality, and in

[5] Bourgoignie, Thierry, 'Characteristics of Consumer Law' (1992) 14 *Journal of Consumer Policy* 293.

[6] Reich, Norbert, 'Diverse Approaches to Consumer Protection Philosophy' (1992) 14 *Journal of Consumer Policy* 257.

[7] Ludwig von Mises, *Human Action - A Treatise of Economics* (Fox & Wilkes, 4th revised ed, 1996) 269- 270; Alan Shipman, 'Privatized Production, Socialized Consumption? Old Producer Power Behind the New Consumer Sovereignty' (2001) 59(3) *Review of Social Economy* 331; Behrang Rezabakhsh, Daniel Bornemann, Ursula Hansen and Ulf Schrader, 'Consumer Power: A Comparison of the Old Economy and the Internet Economy' (2006) 29 *Journal of Consumer Policy* 3.

> what quantities. They are merciless bosses, full of whims and fancies, changeable and unpredictable. For them nothing counts other than their own satisfaction. In their capacity as buyers and consumers they are hard-hearted and callous, without consideration for other people.

That certainly wasn't always the case and in the early history of commerce it was all about 'buyer beware'. As the Industrial Revolution took hold in the United Kingdom and the USA, the marketplace was not a perfect place and suppliers were ruling the marketplace, often colluding on pricing and terms and conditions.[8] There was little interest in consumer protection in the USA until the early 1900s when the Federal Trade Commission was established, but even then nothing happened until the 1960s.[9] Indeed, in 1962 then President John F Kennedy used the term 'consumer rights' in an address to the US Congress and that term has been used ever since.[10] The rights outlined by Kennedy have been expanded to a list of eight today, as defined by Consumers International[11] and incorporated into guidelines issued by the United Nations via their Conference on Trade and Development (UNCTAD)[12] and the Organisation for Economic Co-operation and Development (OECD)[13]. Those consumer rights have been used as the underpinning framework for consumer policy development and have been subjected to academic review by several writers.[14] Chapter Two included a discussion about social theories proposed by John Rawls, who asked the central question: "is there a way of organising societal practices and institutions around principles of fairness and

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[8] Farnsworth, E Allan, *An Introduction to the Legal System of the United States* (Oxford University Press, 4th ed, 2010), 4.

[9] Mark E Budnitz, 'The Development of Consumer Protection Law, Institutionalization of Consumerism, and Future Prospects and Perils (2010) 26(4) *Georgia State University Law Review* 1147, 1151.

[10] Gretchen Larsen and Rob Lawson, 'Consumer Rights: An Assessment of Justice' (2013) *Journal of Business Ethics* 515.

[11] Consumers International, *Who we are: What are consumer rights?* (2019) Consumers International <https://www.consumersinternational.org/who-we-are/faqs/#frequently-asked-questions-what-are-the-consumer-rights>.

[12] UNCTAD, *United Nations Guidelines on Consumer Protection* United Nations <https://unctad.org/en/Pages/DITC/CompetitionLaw/UN-Guidelines-on-Consumer-Protection.aspx>.

[13] OECD, *Consumer Policy* (2019) OECD <http://www.oecd.org/sti/consumer/>.

[14] David Harland, 'The United Nations guidelines for consumer protection' (1987) 10 *Journal of Consumer Policy*, 245–266; N Adkins, & J L Ozanne, 'The low-literate consumer' (2005) 32 *Journal of Consumer Research* 1, 93–105; D Mascarenhas, R Kesavan, & M Bernacchi, 'Buyer- seller information asymmetry: Challenges to distributive and corrective justice' (2008) 28 *Journal of Macromarketing* 1, 68–84.

equality?"[15] In their paper, *Consumer Rights: An Assessment of Justice*, Larsen and Lawson[16] postulate that consumer rights are essentially obtaining justice for the consumer. They suggest that "justice deals with the concept of moral rightness as assessed from various bases including ethics, rationality, law, natural law and religion"[17], and they note that there is ambiguity as to whether that justice refers to an individual or society. On an individual basis, morality would tell us that it is unjust to steal goods from another, and it would be unjust not to pay someone what they were owed.[18] Combined with Rawls' theory, Larsen and Lawson propose:

> The resulting theory of justice is perhaps the most well known exposition of *distributive justice*, by which the proper distribution of things—wealth, power, reward—among people can be judged. It refers to what society owes its individuals. Other forms of justice exist that are useful in the critical evaluation of consumer rights. Two of these relate to the rectification of wrongs and are known as 'retributive justice' and 'restorative justice'. They differ in the approach they advocate to the righting of wrongs.

This thesis has highlighted that the consumer holding any of the three active entitlements when a company ceases to exist would be caused detriment. In concert with the social harm theories, Larsen and Lawson argue that "restorative justice focuses on the needs of victims and offenders with the view to restore them to their proper position in society'.[19] The basis of the Insolvency regime is to assist the 'offender' in this case. Restorative justice for the victim, the consumer, would be to put them in the position they were in before the company ceased to exist. This, in fact, is exactly what is prescribed in ss51-59 Australian Consumer Law[20] while a company continues to trade. For example, should a product or service not be fit for its intended use, the consumer should receive a refund or a replacement item.[21] Why should

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[15] John Rawls, *A Theory of Justice* (Harvard University Press, 1971).
[16] Gretchen Larsen & Rob Lawson, 'Consumer Rights: An Assessment of Justice' (2012) 112 *Journal of Business Ethics*, 515-528.
[17] Ibid 517.
[18] Ibid.
[19] Ibid 519.
[20] *Competition and Consumer Act 2010* (Cth) Schedule 2.
[21] *Competition and Consumer Act 2010* (Cth) Schedule 2 s54.

justice for the consumer stop immediately when the company ceases to trade?

6.3 When various groups are protected.

Justice, through regulatory intervention, for *certain* groups of consumers does not stop when some companies cease to trade. Individuals and corporate investors in the Stock Exchanges in Australia as well as in the USA and the EU are all offered protection. The protection offered is not related to the choice of stocks taken and whether they increase in value, as desired, or lose value. The brokers or dealers who offer services for anyone wishing to invest in the Stock Exchange in Australia must be licenced operators as required under Part 7.6 *Corporations Act 2001* (Cth). Part 7.5 *Corporations Act 2001* (Cth) provides that any financial market must operate a compensation scheme[22] and in Australia there is currently only one financial market, namely the Australian Stock Exchange (ASX), and the compensation scheme is called the National Guarantee Fund[23] (NGF), which is managed by the SEGC.[24] All members or participants in the financial market are required to pay levies as and when required.[25] Should a broker not be able to adequately meet their financial commitments the compensation scheme would receive claims, and make payments, based upon the approved scheme's rules.[26] Therefore, should an Australian investor provide funds to a broker to purchase stocks through the Australian Stock Exchange and the broker ceases to trade while the investor has not received the stocks nor their money returned, they could make a claim on the NGF. However, as highlighted in Chapter Four, only approximately 25% of the Australian population, as individuals, directly invests in the ASX.

An even lower number of Australians would be building or renovating their residential home in any one year and yet each State has created a

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[22] *Corporations Act 2001* (Cth) s881A.
[23] *Corporations Act 2001* (Cth) s889A.
[24] Security Exchanges Guarantee Corporation as nominated by the Minister under s890A *Corporations Act 2001* (Cth).
[25] *Corporations Act 2001* (Cth) s883D.
[26] *Corporations Act 2001* (Cth) s885B.

compulsory insurance scheme for the protection of the consumer/purchaser. The protection is in case the builder is unable to complete the work, or is unable to fulfil the ongoing warranty conditions applicable in each State.[27] Based upon this style of protection mechanism it was considered a possible option as a solution to encourage suppliers and manufacturers to self-insure against insolvency. There was consideration given to this option with the acknowledgement that some insolvency provisions must be altered to allow an insurance policy to continue to be in force after the finalisation of company liquidation, which is currently not the case.

Self-insurance or the management of any compensation scheme by industry groups does not guarantee that all companies would be covered. Whilst those companies and/or groups that are covered could advertise to that extent and genuinely consider it a market advantage, it still leaves the consumer in a situation of having to understand each company's version of compensation, and then also consider if they wish to have a relationship with that company. This situation may lead to unfair market practices due to high costs of participation and preferences towards larger companies at the expense of smaller ones.

Even though Employee Entitlements are listed part way down the liquidation schedule of priority payments[28], the Commonwealth government has created a fund[29], which will provide employees with their entitlements should the liquidation process not make sufficient funds available for that purpose.

6.4 In Summary

The situation of consumers losing the total value of their active entitlements when a company ceases to trade has been occurring in Australia and around the world for decades.[30] The findings of this thesis have put a spotlight on that 'elephant in the room'. It has been an easy task for politicians to thrust the

[27] All of these conditions and thresholds were detailed in Chapter Four.
[28] *Corporations Act 2001* (Cth) s556(1)(e).
[29] Department of Jobs and Small Business, *Fair Entitlements Guarantee (FEG*) (17 December 2018) Australian Government <https://www.jobs.gov.au/fair-entitlements-guarantee-feg>.
[30] Lynn M LoPucki, 'The Unsecured Creditor's Bargain' (1994) 80(8) *Virginia Law Review* 1887, 1896.

consumer into the default position of unsecured creditor within an insolvency system that has no goal of protecting the consumer, and politicians have let this situation continue.

Most commonly, creditors are entities that choose to be in the position of being owed money.[31] They choose to be in that position after having the option of negotiating with a company about the supply of a product or service for a price that will be owed to the entity, usually via a regular payment. Where large value items are involved, the entity will seek to have their owed amount, or debt, secured by something that is valuable. In Australia these securities are registered on the Personal Property Security Register.[32] In February 2019, a typical newspaper article about a company suffering financial difficulties reported[33] that "more than $1 million was estimated to be owed to creditors, including suppliers and employees". Furthermore, "potential creditors also include customers who bought rugs from the affected companies and were seeking refunds or guarantees". Suppliers may be covered by some security registered in the PPSR. Employees have a back-up with the Fair Entitlements Guarantee (FEG) where:[34]

> The Australian Government provides financial assistance to cover certain unpaid employment entitlements to eligible employees who lose their job due to the liquidation or bankruptcy of their employer.

As described in Chapter Four, the FEG is the latest iteration of government attempts to provide this important assistance. The introduction to the 2011 Australian Government discussion papers[35] regarding employee assistance schemes noted that it took several large corporate collapses before one Member of Parliament decided to act. More alarmingly, however, it was noted:

> The spate of corporate closures highlighted the difficult position of employees and creditors when a corporation and non-corporate trading entities become

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[31] Ibid, 1899.
[32] See www.ppsr.gov.au.
[33] Liam Walsh, 'Parts of Rugs a Million hit the wall', *Courier-Mail* (Brisbane), 2 February 2019, 51.
[34] Department of Jobs and Small Business, *Fair Entitlements Guarantee (FEG)* (17 December 2018) Australian Government <https://www.jobs.gov.au/fair-entitlements-guarantee-feg>.
[35] Parliament of Australia, *Meeting employee entitlements in the event of employer insolvency* (4 April 2011) Parliament of Australia <https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/BN/1011/EmployeeEntitlements>.

> insolvent. *Business closures can be expected under the normal competitive workings of the economy, and indeed economic theory encourages the removal of inefficient or unprofitable businesses from a given market.* (emphasis added)

The numbers of companies that exit from the business scene on an annual basis have already been outlined in Chapter One, along with the number of those annually entering external administration. Clearly the highlighted passage above illuminates to the reader the fact that government does know companies fail; indeed they expect a rate of failure, but have sparingly reacted on an ad hoc basis to protect some groups from exposure, rather than all consumers. The choice to be in business involves being confronted by many risks on a regular basis, but those choices are made knowingly.[36] The choice for a consumer of which business to deal with should not be confronted with any risk regarding the business, only the product or service the consumer wishes to purchase. The extent of the cost to consumers of addressing issues with suppliers was highlighted by the results of consumer surveys conducted by the Australian Treasury Department in Chapter Three. It is raised here as a concern that the extent of issues encountered by consumers where a company has ceased to trade is not currently measured.

When considering regulatory reform, the evolution of changes made during the history of the stock exchange and the building industry provide significant guidance. Command-and-control regulations that forced companies to use trust accounts, register builders using structured guidelines, and licencing stockbrokers, whilst making those industries more transparent and reliable, did not solve the core issue.[37] As stated above, normal workings of the economy will see companies come and go. The ASX continues to encourage listed businesses to accept greater Corporate Social Responsibility by publishing 'Corporate Governance Principles and Recommendations'.[38] In

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[36] Vanessa Finch, 'Security, Insolvency and Risk: Who Pays the Price? (1999) 62(5) *The Modern Law Review* 633.

[37] David Ulbrick, 'Constructing the great Australian dream: Formation of domestic building contracts in Victoria' (2010) 28 *Business Corporation Law* 78; A L Lougheed, *The History of the Brisbane Stock Exchange 1884-1984* (Boolarong Publications, 1984).

[38] Corporate Governance Council, *Corporate Governance Principles and Recommendations* (27 February 2019) Australian Stock Exchange

that document companies are urged to mitigate, amongst other things, their *social risk*.[39] Whilst this principle is to be applauded, the core issue remains.

The quest for this thesis, however, has been to present a potential solution for the situation where any of the three active entitlements are lost due to company insolvency and the consumer will always be covered. This thesis has incorporated the OECD-developed Toolkit [40] 'six-step approach to consumer policy issues' as described at 3.1.2.1. The toolkit is used by the Australian Government when developing Consumer Protection legislation. Each step was clarified at the appropriate research stage and confirmed as complete, validating that the solution offered to the topic of this thesis has some merit based on the federal government's own policy.

Australia could be at the forefront of regulatory reform with amendments that would more fully protect the consumer when a company fails. This regulatory reform should occur without a major corporate collapse prompting another review. The solution proposed in Chapter Five, would benefit all groups of consumers at the point when a company fails. The creation of the Australian Consumer Compensation Scheme would resolve the consumer detriment currently experienced.

6.5 Australian Consumer Compensation Scheme

Based on the UK FSCS Fund sub-scheme[41] concept and the Core Principles developed by the International Association of Deposit Insurers, [42] the

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<https://www.asx.com.au/documents/regulation/cgc-principles-and-recommendations-fourth-edn.pdf>.

[39] Ibid, 36, **social risks**: the potential negative consequences (including systemic risks and the risk of consequential regulatory responses) to a listed entity if its activities adversely affect human society or if its activities are adversely affected by changes in human society. This includes the risks associated with the entity or its suppliers engaging in modern slavery, aiding human conflict, facilitating crime or corruption, mistreating employees, customers or suppliers, or harming the local community. It also includes the risks for the entity associated with large scale mass migration, pandemics or shortages of food, water or shelter

[40] OECD, 'Consumer Policy Toolkit' (9 July 2010) <http://www.oecd.org/sti/consumer/consumer-policy-toolkit-9789264079663-en.htm>.

[41] Financial Services Compensation Scheme, *How we are funded* (2021) FSCS <https://www.fscs.org.uk/about-us/funding/>.

[42] International Association of Deposit Insurers, *IADI Core Principles for Effective Deposit Insurance Systems* (November 2014) IADI <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf>.

Australian Consumer Compensation Scheme (ACCS) would be structured in a manner to contain costs of claims to the industry groups in which a defaulting company operates, whilst all companies would contribute to the ongoing operation of the scheme. Basic costs of the scheme must include funding for education programmes for both industry and consumers. Consumers must understand their rights and also responsibilities in claiming any benefits from the scheme.

From a regulatory theory perspective, this scheme must be command-and-control regulation to ensure that all companies and sole traders participate in the process so that their customers are covered. This proposal relies upon the cooperation and integration of information from several Commonwealth government agencies including ASIC[43] and ATO.[44] High-level cooperation of these large agencies must come under significant legislation at the highest level. It must be noted that the following are guidelines and it is beyond the scope of this thesis to provide a detailed operating scheme. As noted at 5.9.1, significant information must be gathered to quantify the scheme and the overall cost may well be a barrier to implementation.

The proposed Core Principles of the ACCS are:

Core Principle 1 – Public Policy Objectives

> The principal public policy objective for the Australian Consumer Compensation Scheme is to protect consumers who hold Active Entitlements at the time a company ceases to trade. These objectives should be formally specified and publicly disclosed. The design of the scheme should reflect the public policy objectives.

Core Principle 2 – Mandate and Powers

> The mandate and powers of the Australian Consumer Compensation Scheme and the scheme manager should support the public policy objectives and be clearly defined and formally specified in legislation.

Core Principle 3 - Governance

[43] Australian Securities and Investments Commission.
[44] Australian Taxation Office.

The ACCS manager should be operationally independent, well governed, transparent, accountable, and insulated from external interference.

Core Principle 4 - Relationships With Other Safety-Net Participants

In order to ensure the ACCS manager is unobstructed in its performance, there should be a formal and comprehensive framework in place for the close coordination of activities and information sharing, on an ongoing basis, between the ACCS manager and other government agencies, both domestic and international.

Core Principle 5 – Cross-Border Issues

Where there is a Consumer Compensation Scheme operating in another jurisdiction, formal information sharing and coordination arrangements should be in place between Australia and the relevant jurisdictions to ensure extended consumer protection.

Core Principle 6 – Membership

Membership in the Australian Consumer Compensation Scheme should be compulsory for all companies, partnerships and trusts (any trading entity).

Core Principle 7 – Coverage

Policymakers should define clearly the level and scope of ACCS coverage. Coverage should be limited to consumers and goods and services as defined in the Australian Consumer Law. The ACCS coverage should be consistent with the scheme's public policy objectives and related design features.

Core Principle 8 – Sources And Uses Of Funds

The ACCS manager should have readily available funds and all funding mechanisms, including assured liquidity funding arrangements, necessary to ensure prompt payment of valid compensation claims. Responsibility for paying the cost of maintaining the fund and the fund manager should be borne by member trading entities.

Core Principle 9 - Public Awareness

In order to ensure complete consumer protection, it is essential that the public be informed on an ongoing basis about the benefits and limitations of the Australian Consumer Compensation Scheme.

Core Principle 10 - Legal Protection

The ACCS Manager and individuals working both currently and formerly for the ACCS Manager in the discharge of its mandate must be protected from liability arising from actions, claims, lawsuits or other proceedings for their decisions, actions or omissions taken in good faith in the normal course of their duties. Legal protection should be defined in legislation.

Core Principle 11 - Compensation Payments

The ACCS should compensate consumers promptly upon declaration of a trigger event. There should be a clear and unequivocal trigger for compensation to occur.

Core Principle 12 - Recoveries

The ACCS Manager should have, by law, the right to recover its claims in accordance with the statutory creditor payment hierarchy.

Core Principle 13 - Assessment of Compliance

A regular review of the compensation scheme should be completed, at least bi-annually, by an independent third party to ensure that policy objectives remain valid and the scheme continues to meet those objectives as well as being the most effective and efficient scheme possible.

Returning to the theory of political motivation, as explained in Chapter Two, it would be obvious that in the early days of the stock exchanges, only the very wealthy could have invested and they were therefore the only ones who may have been caused detriment if a broker collapsed. Only wealthy men were politicians too in those days, and logically the wealthy investors lobbied the

wealthy politicians to create the compensation fund,[45] supporting the 'capture theory'.

The ACCS is an opportunity for Members of Parliament from all sides of the political spectrum to regulate in the 'public interest'.

6.6 Contribution of thesis

This thesis has extensively reviewed the policy of Consumer Protection in Australia whilst being informed by similar policies in the large consumer federations of the USA and the EU. As the marketplace has developed and the skills of the seller in the marketplace have developed, legislation has been progressively introduced to balance the power between the seller and the buyer.[46] The major changes in legislation in Australia began with the *Trade Practices Act 1974* (Cth) along with the Sales of Goods Acts and Fair Trading Acts within each of the Australian states. The relatively recent review and re-statement of those Acts as the Australian Consumer Law has progressed consumer protection further; however, the door has still been left wide open for many consumers. The fate of consumers protected by 'guarantees' proclaimed by the Australian Consumer Law is left in limbo when a company ceases to trade. Those guarantees cease as, and when, a company ceases to trade. The affected customers today will almost always be caused detriment and will have to pay more money to place themselves into the position they expected to be in should the company have continued to trade. The recommendation proposed, the Australian Consumer Compensation Scheme, would resolve the detriment caused to those consumers, with minimal commercial detriment to suppliers and manufacturers. The regulations relating to the insolvency of a company should continue to focus on the restructuring of the company, or the orderly process of winding up the company, and providing dividends to those entities that have wilfully decided to be creditors of the insolvent.

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[45] Roger Hamilton, 'Stockbrokers and Their Clients' Securities' (1978) (June) *Australian Business Law Review* 137.

[46] Vicky Comino, 'The adequacy of ASIC's "tool kit" to meet its obligations under corporations and financial services legislation' (2016) 34 *Company and Securities Law Journal* 360.

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