

The case studies selected for this report include cases that are illustrative of the legal and banking practice issues raised in disputes, the investigation process and different types of resolution. The case studies relate to single cases or a group of cases about the same issue.

## Travel Agent Chargebacks

During the reporting year the Ombudsman concluded an investigation into the banking industry practice of charging back disputed credit card transactions when an airline company failed to provide the service booked by travel agents. The investigation was requested by The Australian Federation of Travel Agents Limited ('AFTA') on behalf of its members.

As the Ombudsman can only consider a dispute between a member bank and its customer, AFTA was asked to advise its own members that met the small business test set out in the Terms of Reference, to write directly to the Scheme. The Ombudsman received 102 separate disputes from travel agents, involving seven member banks.

### Issue

After the collapse of Ansett Airlines, many consumers who purchased pre-paid tickets using a credit card claimed a refund from their bank and the refund was processed on the basis that the service they purchased was not provided. Consumers' banks claimed the refund from the merchants' banks, under the credit card scheme rules. The merchant banks in turn claimed the refund from the merchant under the terms of the merchant agreement. This process is called a 'chargeback'. Where the travel agent had used its own merchant facility to process the payment, the chargeback was to their account.

AFTA said that its members suffered substantial losses as a result of the chargebacks following the collapse of Ansett and other airlines following the events on 11 September 2001.

In summary, AFTA said that:

- the banks were unilaterally charging back disputed credit card transactions to travel agents, when they had already passed on the funds to the failed entity; and
- the travel agents were bearing the loss even though the consumer had a claim against the failed travel entity, under a travel insurance policy or in some cases the Travel Compensation Fund.

In general, the bank response was:

- The card schemes (Visa, MasterCard and Bankcard) determined that the right of chargeback rests with the cardholder's bank or the consumer;
- The chargeback does not prevent the merchant from seeking payment directly from the purchaser; and
- The merchant agreement between the bank and the travel agent entitles a bank to chargeback a disputed credit card transaction if the cardholder disputes a transaction 'for any reason'.

### Investigation and Resolution

The first question considered was what was supplied in return for the payment made by credit card. Was it travel or was it a ticket? The second question was, even if what was supplied was a ticket rather than air travel, was the chargeback nevertheless able to be passed on by the bank to the travel agent under the merchant agreement?

There are respectable arguments either way as to whether a ticket or travel was purchased but, on balance, our view was that the service provided and the supply involved in the transaction was the provision of a ticket. Travel is provided by the airline under a separate contract of carriage.

Therefore, it was BFSO's view that the cardholder, if a ticket was issued, or accommodation booked, received a service from the travel agent. The chargeback reason given did not therefore apply so far as the travel agent was concerned. The cardholder was unable to travel because of the failure of the airline.

The chargeback rights and requirements are identified in the operating rules of the various card schemes (Visa, MasterCard and Bankcard). Because the card schemes are not members of BFSO the Ombudsman has no jurisdiction over them. Further, at the time of this investigation, BFSO was unable to refer to and rely on the full text of the relevant chargeback rules because they were confidential as between the card schemes and the member financial institutions. Neither the cardholder nor the merchant has any direct contractual agreement with the card schemes.

The travel agents' obligations and the banks' rights in relation to credit card transactions processed through the credit card merchant facilities are set out in the merchant agreement between the merchant and the bank.

In each of the seven merchant agreements reviewed it was concluded that the bank was entitled to chargeback invalid or disputed transactions 'if the cardholder disputes liability for the transaction for any reason'. It was concluded, in the majority of cases, that the banks were entitled to chargeback the disputed credit card transactions to the travel agents.

It was also concluded that in passing on a chargeback under the terms of the merchant agreement a bank is denying the travel agent payment under the credit card payments system, but is not denying the merchant the right to seek payment in other ways. The terms of the merchant agreement do not impact on a merchant's contractual rights and obligations in relation to third parties, including any right to be paid for goods or services supplied. It is a matter for the travel agent (and its legal advisors) as to whether action is taken to seek payment and against whom.





### Failure to Register Transfer of Land

In August 2001 Mr & Mrs B purchased an apartment in Queensland which was mortgaged to the bank. Approximately one year later, the disputants made plans to erect a pergola on the terrace and lodged plans with the local council. Mr & Mrs B made plans to travel to Queensland to attend to building the pergola.

The council rejected the disputants' plans on the basis that submission was required to be made by the registered owner.

Mr & Mrs B became aware that at the time the property was purchased and the mortgage was drawn, the bank did not transfer the title into their names and the title remained in the name of previous owners.

Mr & Mrs B alerted the bank to the problem and advised the bank that it was urgent that the situation was rectified as they were planning travel to Queensland. The bank confirmed that the title had not been transferred and said that it would attend to it.

Mr & Mrs B departed for Queensland by car. When they arrived they attended the council with multiple documents to show they were the true owners of property. The council still rejected the plans. Mr & Mrs B telephoned the bank several times to advise it of the current status and to request that the bank move quickly on the problem. Five days later, when title still had not been transferred to Mr & Mrs B's name, they returned home from Queensland.

Mr & Mrs B claimed \$3,600 in loss, comprised of annual leave, accommodation, vehicle expenses, phone calls, copies of documents and meals resulting from the wasted trip to Queensland.

BFSO referred Mr & Mrs B's dispute to the bank. The bank rejected Mr & Mrs B's claim for costs but agreed to offer \$2,000 in recognition that the bank's actions contributed to Mr & Mrs B's situation.

### Resolution

The disputants called the case officer to discuss the bank's offer. Mr & Mrs B decided to make a counter offer to the bank of \$2,600. The bank agreed to pay Mr & Mrs B \$2,600. The case was closed at a Case Resolved level.

## Early Termination of Fixed Interest Rate Loan

Mr & Mrs S applied to the bank for a loan, through a mobile lender. The application was approved, but they were unsure whether to take a fixed or variable interest rate. Mr & Mrs S say they were told not to worry, because they would receive a 'free switch voucher' which would allow them to switch from one type of loan to another free of charge, within the first two years. They took a three year fixed interest rate loan.

One year later, Mr & Mrs S wanted to consolidate their home loan with a student loan in Mrs S's name, and do some renovations. They went to the bank with their voucher, but were told that they would need to pay approximately \$5,000 to switch by refinancing to a variable rate loan. This was an early termination interest adjustment ('ETIA') fee. They did not refinance, but complained to BFSO that they had been misled.

The bank said that, as the voucher stated that the ETIA might be payable when switching from a fixed rate loan, it was not misleading. However, the voucher said that the holder could 'switch to another loan free' and the normal switching fee would be waived. There was no mention in the loan agreement of any switching fee. The bank said that there was no specific switching fee applicable when the voucher was given. Hence, it appeared not to waive anything.

The case manager's finding was that any explanation offered by the lending consultant would be vital to a customer's understanding of what the voucher offered and its limitations.

Mr & Mrs S, and their parents said that the voucher had been described as being 'worth gold' by the lending consultant. The consultant could not recall if those words had been used or not.

Mrs & Mrs S said that no mention was made of an ETIA being payable if the loan were paid out during the fixed rate period. The consultant said that he told them that if they paid more than \$500 to the loan at a time, they would incur a fee. The case manager found that this was not sufficient to alert Mr & Mrs S of the fact that 'switching' from fixed to variable rate meant paying out the entire loan, and an ETIA would be payable and could be significant, despite the voucher.

## Investigation and Resolution

The case manager found that the voucher was worth little, if anything, and Mr & Mrs S would have taken more care in choosing their loan, had they not been misled about the limitations of the voucher. They were unsure what product they would have taken, but thought that they would not have locked themselves into a three year fixed rate. The Finding was that they would more likely have taken a two year rate, and the loan was recalculated on that basis. Mr & Mrs S paid out the loan after 22 months, incurring almost \$2,500 in ETIA. With a two year fixed rate, they would have incurred an ETIA, but it would only have been \$150. The bank refunded the difference.

## An Upset Holiday

This dispute concerned a mistaken withdrawal of \$1,924.34 from Mrs C's savings account whilst she was overseas on holiday. Mrs C said that as a result of the mistake, she could not complete the remaining 28 days of her holiday and had to return to Australia.

Mrs C claimed \$5,583 in compensation, including the cost of accommodation, visas and train tickets that were not used and the cost of a return flight to complete the trip.

In response to the dispute, the bank said that the problem could have been rectified had Mrs C contacted the local branch by telephone. The bank had no record of Mrs C attempting to contact it. The bank said that it acknowledged that Mrs C's husband had called at one of its branches to discuss the situation but it did not have authority to speak to him about the account. The bank said that when it was made aware of the error upon Mrs C's return it was rectified immediately.

The bank made an offer of \$712, which it increased to \$1,000.

## Resolution

The case was resolved by negotiation between the parties conducted by the Ombudsman. The bank agreed to pay Mrs C an amount of \$2,000 in full and final settlement of the dispute.

### Transfer to Wrong Account

Ms K's brother went to his bank to transfer \$10,000 to Ms K's account. Five days later the transfer had not been credited to Ms K's account and her brother's bank put a trace on the transfer.

The account number given by Ms K's brother to his bank was an eight digit number. Ms K's bank operated with nine digit account numbers. In this case the seventh number in the sequence was missing.

Ms K made phone calls to her bank to try and locate the money and was informed that as the account number only had eight digits, the bank added a zero to the front of the account number to create a valid account number. As a consequence, the \$10,000 was transferred to another of the bank's customers.

The sum of \$6,967.95 was recovered from the recipient and repaid to Ms K. The recipient had spent the balance of the transfer and Ms K was owed \$3,032.05. The bank indicated to Ms K that she would have to accept the balance in instalments from the recipient.

Ms K wrote to the Ombudsman and said the payment was made as a result of a bank error and that the bank ought to refund the balance owing to her, with the bank being responsible for the collection of instalments from the recipient.

In its response to the Ombudsman, the bank said that it processes transactions in accordance with the Procedures for Bulk Electronic Clearing System ('the BECS Procedures') published by the Australian Payments Clearing Association Limited ('APCA'). There is nothing in those procedures requiring it to check the account name and number prior to processing a voucher of this type. In addition the BECS Procedures state that the receiving institution is only required to use the BSB and account number in processing the credit. The bank also noted, however, that this specific transaction did not fall under the BECS Procedures.

The bank agreed that it added a zero to the front of the account number given by Ms K's brother to his bank. The bank said that its account numbers must contain nine characters and that adding a zero to the front did not alter the validity of the account number.

#### Investigation and Resolution

The case manager found that the members of APCA, which includes the bank, have agreed between themselves to abide by the BECS Procedures when processing electronic transactions. The procedures are a contractual arrangement made between industry participants and bank customers are not a party to them. Therefore, the BECS Procedures were not part of the contract between the bank and Ms K and they could not be relied upon by the bank in a dispute between the bank and its customer.

The case manager also found that upon the receipt of the eight digit number, the bank had intervened and added a ninth digit, being a zero, to the front of the account number. The processing operator assumed that the number was missing a zero from the front, whereas the missing number was in fact the seventh digit. Even if the BECS Procedures could be relied upon, in processing the transaction by adding a zero to the front of the eight digit number provided by Ms K's brother, the bank did not use 'only' the BSB and account number given to it.

The case manager's view was that the bank did not comply with its contractual obligation pursuant to its terms and conditions.

The bank's terms and conditions stated that the bank 'may' not use the account name to validate the transaction. The case manager found that the use of the word 'may' indicated that use of the account name is in the discretion of the bank. The case manager concluded that because the account number was incomplete or obviously wrong, the bank ought to have used the account name to validate the transaction. Alternatively, the bank should have returned the transaction to the sender for further instructions.

The case manager also found that if the bank's terms and conditions operated to exclude the liability of the bank, then the operation of that clause of the terms and conditions was in breach of the implied statutory warranty to render due care and skill found in Section 12ED of the ASIC Act.

The case manager formed the view that the bank had not exercised 'due care and skill' or the care and skill of a reasonable banker nor had it engaged in good banking practice by adding a zero to the eight digit number. The bank ought to have matched the number with the account name before processing the transaction. Alternatively, it ought to have sought further information from the sender or returned the transfer back to the sending bank.

The case manager found that the bank should pay Ms K the balance of funds that were not recovered from the recipient, being the sum of \$3,032.05. The parties accepted the Finding.

## Instructions Not Followed

Mr I was residing in a correctional facility when he learned that his ATM card, which he had left with his defacto, had been acquired by a third party. With the help of counsellors at the correctional facility, Mr I faxed a letter to his bank branch advising it to cancel his ATM card because he was concerned that the card was in the hands of an unauthorised party.

At the same time, Mr I was expecting a deposit of about \$18,000 to his account, which was the proceeds from his deceased mother's estate.

Mr I did not receive a response and faxed the bank's branch several more times. The bank would not accept Mr I's instructions and advised him that he must attend the branch or sign an Authority and Indemnity form.

Some time passed while Mr I, with the assistance of the counsellors, attended to the bank's request. During this time, the account remained open and operational and \$18,400 was electronically withdrawn with Mr I's card and PIN for that card, without his authority.

Mr I wrote to the Ombudsman to dispute the bank's actions and appointed a counsellor to act as his agent.

The dispute was referred to the bank. When the bank did not respond to BFSO by the due date, the case officer sent a reminder fax to the bank, outlining that the central issue for consideration was the failure to put a stop on Mr I's card.

## Resolution

Soon after the bank wrote to Mr I advising him that it had completed its investigation and that his account was to be reimbursed with \$18,400 together with fees and interest as appropriate. The case was closed at Case Resolved.





### Progress Payment to Builder

Mr & Mrs Y engaged a construction company to build their home. Before the building was completed, provisional liquidators were appointed to manage the financial affairs of the construction company. Mr & Mrs Y complained to the Ombudsman that the bank made a payment to the provisional liquidators for the 'lock-up' stage, when the house was not at this stage. They said that the bank should have inspected the property before making the payment because the house was in such a state that it had to be demolished due to defective workmanship.

In its response, the bank said that it is the customer's responsibility to ensure that building works have been completed to their satisfaction when there are progressive payments to a builder. The bank said that there was no requirement or obligation on it to inspect the property and it made the payment in accordance with the authority signed by Mr & Mrs Y.

### Investigation and Resolution

To determine if there was a legal requirement or obligation on the bank to inspect the property before releasing the payment for the lock-up stage, the case manager examined the bank's policy for progress payment inspections, the terms and conditions of the contract and the bank's practice, both generally and in this case.

The bank's policy did not require inspections for residential housing projects under \$1million. Its practice in this case was consistent with the policy, in that no inspections had been made before progress payments were made.

There was no allegation that the bank represented that it would inspect the building at the various stages of construction and it did not contribute to Mr & Mrs Y's mistaken belief that the bank would inspect the building.

The terms and conditions of the contract absolved the bank from a contractual liability to the borrowers to inspect the building before releasing a payment. As Mr & Mrs Y authorised the payment to the provisional liquidators, the bank was entitled to release the payment. The case was closed after the Finding expressed the view that there was no payment to be made by the bank.

## Adverse Credit Listing

Mr R used his credit card a number of times during September and October 1997 to make purchases. He went away to a remote area of Australia for approximately two months to work, returning in December 1997. From October to December 1997, Mr R made no payments to the account causing it to fall into arrears.

The bank sent arrears notices to Mr R's address. He acknowledged having read them when he returned home but did not make any immediate payment to the account.

In late January 1998, Mr R made a payment to the account, and Mr R continued to use his card. The account was still operating in 2002.

Between February 1998 and May 2002, Mr R applied for one home loan and eight personal loans, all of which were rejected by the various lenders he approached. In May 2002, he was informed by a lender that his application was rejected on the basis of a credit report. He obtained a copy of his credit file and saw that the bank had listed the debt as a 'clearout', or 'serious credit infringement'. This type of listing indicates to other lenders that a debtor has fraudulently obtained credit, evaded his obligations or exhibited an intention to no longer comply with his obligations in relation to the credit card account. Mr R then contacted the bank about the listing and the bank removed it.

Mr R wrote to the Ombudsman, saying that the listing had prevented him from obtaining loans over a significant period of time.

### Investigation and Resolution

The case manager found that it was unclear whether the clearout listing had been made in error or intentionally. The credit listing had, however, been updated to show that the debt had been paid in late January 1998, but the clearout listing was not removed or amended at this time.

The case manager also found that Mr R's account had been in default in January 1998, and the bank would have been justified in placing a default listing on his file. Nevertheless, it would not have been justified in listing him as a clearout, as he had not been given prior warning of such a listing, and, had the bank taken sufficient steps to determine Mr R's whereabouts in late 1997, it would have been aware that he had not 'cleared out'.

The case manager also concluded that existence of the clearout listing was disclosed to the lenders whom Mr R approached over the following four years, but it could not be determined that the loans for which he applied would have been approved, even in the absence of the listing. However, it was likely to have impacted on the decision of the lenders he approached.

The Finding was that the bank should pay Mr R \$2,000 as compensation for distress and inconvenience. Mr R and the bank accepted the Finding.

### Maladministration in Granting Credit

Mr P applied for a credit card without stipulating a preferred credit limit. Mr P's application was assessed using the bank's credit scoring system and he was offered a credit card with a limit of \$8,000. The entire amount was spent by Mr P, who then had difficulties repaying the debt.

Mr P was 22 years of age and had only been in employment for six weeks with his current employer at the time of the application. The application showed that he had previously been employed for a three month period elsewhere. The pay slips provided by Mr P to the bank did not support that he was employed on a full-time basis, as the hours worked by Mr P varied substantially from week to week.

Further, although Mr P's current income (shown from the payslips provided) was sufficient to service the proposed limit of \$8,000, the information on the application indicated that Mr P had no previous borrowing history and no savings were evident.

When assessing disputes about maladministration in the granting of credit, BFSO takes into account the following:

- Assessing the ability to repay is to be made in accordance with the Uniform Consumer Credit Code ('the UCCC') and according to what is good banking practice. One consideration in the UCCC is whether, at the time of entering into the contract, the credit provider knew or could have ascertained by reasonable inquiry of the debtor that the debtor could not pay the debt in accordance with the terms of the contract or without substantial hardship; and
- A diligent and prudent bank should rely on all of the information known to the bank and seek up to date information from its customer before forming an opinion about the capacity to repay.

### Investigation and Resolution

The case manager formed the view that she could not be satisfied that the bank's credit scoring process as applied in this case was sufficient to satisfy the bank's obligation under the UCCC or to satisfy the reasonable banker test. The case manager also concluded that although it was arguable that Mr P should not have been granted the credit at all, against that, he clearly had use of the funds.

The bank agreed to make the following offer to Mr P:

- to reduce the outstanding debt to \$4,000;
- to waive all future fees and interest charges;
- repayment to be made in increments of \$85 per month for 47 months, with a residual of \$5 payable at the 48th month, to finalise the debt; and
- Mr P could choose to repay the debt earlier if preferred.

The offer was put to Mr P by this office, who then responded with a counter-offer to repay \$2,000 over a period of 30 months with minimum monthly repayments of \$66, as a final resolution to the dispute. This was accepted by the bank and the matter was resolved.

## Unsolicited Credit Card Increase

In 1997 Ms D applied for a credit card with a credit limit of \$2,000. The facility was approved. At the time, Ms D was employed.

In 1998 Ms D left work to have a baby and started to receive a sole parent's benefit.

In 2001 Ms D received an invitation from the bank to increase her credit limit to \$4,000. Later the same year, the bank offered to increase her credit limit from \$4,000 to \$10,000. Each time, she was simply required to return a signed request form to accept the limit increase.

At the time of writing to this office, Ms D's credit card balance was at the limit. She asked whether the bank should have increased the limit to \$10,000 when she was receiving a sole parent's benefit. She pointed out that the sole parent's benefit has always been paid to her savings account with the same bank. She was having great difficulty paying the interest on the credit card debt in addition to her normal living expenses. She was considering bankruptcy, as she did not feel she could service the credit card debt any longer.

### Resolution

Following referral of this dispute to the bank, the bank wrote to Ms D and offered to reduce her credit card debt and credit limit from \$10,000 to \$4,000. Ms D accepted the bank's offer and the file was closed at Case Resolved level.

## Credit Card Fraud

In December 2000, Mr M applied for an 'on-line eCommerce merchant facility', which was approved by the bank, subject to the bank's usual terms and conditions.

Mr M set up a website, which offered various products for sale. He was contacted by e-mail by a person from Indonesia who requested goods advertised on the website. Mr M agreed to sell the goods and instructed the customer, who wished to pay by credit card, to use the secure 'gateway' service to which Mr M subscribed. This service took the card number and expiry date quoted by the customer and sought authorisation for the transaction from the cardholder's financial institution.

When Mr M was notified that the transaction had been authorised, the goods were dispatched to the customer in Indonesia. Some weeks later, Mr M was contacted by an American man, who said that the card number used was his, but that he had not ordered any goods from Mr M. The man's bank processed a chargeback to Mr M's account.

Mr M had no doubt that his business had been the victim of fraud, but said that his business should not bear the cost, because the bank had been negligent in authorising the transaction and had not warned merchants of 'high risk countries'. He also complained that the bank's systems for obtaining authorisations permitted fraud.





### Investigation and Resolution

The case manager examined the Merchant Agreement and Operating Guide provided to Mr M when the facility was established, and found that:

- The guide made clear that internet sales carried an increased rate of fraud;
- The fact that a card number was quoted gave no assurance that the card was being used by the cardholder;
- Authorisation at the point of sale meant only that the cardholder's bank had verified that the card was not reported lost or stolen and that sufficient credit remained in the account to cover the transaction;
- If the cardholder did not authorise the transaction, the bank could charge it back to the merchant's account.

The case manager issued a Finding which was that Mr M bore the risk of fraud in this case, and the bank should not be required to refund any of the amount charged back. Mr M rejected the Finding, saying that the bank did not take sufficient steps to protect merchants from fraud.

The Ombudsman reviewed the Finding and Mr M's response and determined that the bank had warned the disputant of the risks inherent in internet transactions. The Ombudsman recommended that no compensation be paid.

The Ombudsman, nevertheless, recommends that merchants' banks do not use the word 'authorisation' when referring to verification that the card has not been reported lost or stolen and the account has sufficient funds. It is too easily confused with cardholder authorisation for the transaction.