IN THE DISTRICT COURT
AT AUCKLAND

CRI-2012-004-011695

THE QUEEN

v

LOVE SPRINGS LIMITED
PHILLIP JOHN SMART

Hearing:	11 December 2013
Appearances:	J Dixon and B Hamlin for the Crown A Lloyd and I Rosic for the Prisoners
Judgment:	11 December 2013

NOTES OF JUDGE R COLLINS ON SENTENCING

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[1] Love Springs Limited and Phillip John Smart are both for sentence on charges of breaches of s 10 Fair Trading Act 1986 and Love Springs alone for sentence pursuant to s 47J of that Act.

[2] Love Springs faces 11 charges involving allegations of being in trade engaged in conduct that was liable to mislead the public as to the nature, characteristics or suitability for purpose of goods. Those 11 charges relate variously to periods in time from 7 August 2009 to 15 February 2009.

[3] The charges are representative in nature and to reflect that representative nature and to reflect the nature of allegations the Commission brought, they are divided into 11 regions being Manukau, Auckland, North Shore, Rotorua, Hamilton, Papakura, Whakatane, Lower Hutt, Porirua, Fielding and Bulls.

[4] Following a defended hearing, which occupied four days in March of this year and three days in July this year, I convicted Phillip John Smart, the director of the company, of being a party to that offending on seven of those informations. The exceptions being that he did not face charges in relation to Lower Hutt, Porirua, Fielding or Bulls.

[5] The misleading conduct is broadly summarised as follows; it is alleged that Love Springs' sales representatives sold door-to-door and, in fact, that is accepted and not in dispute that that is how the company marketed the particular water filters.

[6] In marketing or selling the product in that way representations were made to members of the New Zealand public that tap water presented all sorts of health problems for New Zealanders. Those representations were consistent with how a significant number, in my view, of the trainees were being trained. That is they were being trained to develop the belief that tap water was dangerous to consumers' health, that tap water could cause cancer, birth defects, leukaemia and miscarriages, that tap water contained bacteria such as giardia, cryptosporidium and other similar impurities. The sales representatives were encouraged, whether explicitly or implicitly, to relay that information to consumers. That message was a critical message in the company's selling technique and that is so particularly in relation to step 3 of that technique, "building the need".

[7] In the agreed facts for the charges that Mr Smart faced, and in the summary of facts for the Love Spring sentencing, it is easy to get an appreciation of the significant extent to which these misrepresentations were made.

[8] It was common ground in the charges against Mr Smart that a Close Up programme went to air on Television One. That programme was highly adverse to the company and brought to public light the type of allegations that were being made about tap water. In fact, during that programme, a quite damming clip of Anthony Beach during a training programme was aired as a part of the Close Up programme. It is significant to note that in relation to the charges the company faces, the dates in a number of the informations (if not all) extend well past the airing of the Close Up programme.

[9] There have been submissions today regarding the nature of the findings that I made with respect to Mr Smart. I wish to make it clear, so that there is no doubt certainly on sentencing, I utterly reject the notion that the offending by Love Springs was the result of chance. I reject that it was the result of spontaneous, random actions by individual trainers and individual sales representatives. As I said in the judgment, in finding culpability in relation to Mr Smart, this was a selling company; its focus was how it sold. Mr Smart in evidence confirmed his passion for selling and it chose as a method of sale door-to-door selling. How its trainers were trained and how they sold door-to-door was absolutely vital to the company's success. I will come to the question of sales revenues later but my view is that this company was successful selling in that way.

[10] Assessing all of the material I have, I am in no doubt that the approach of the company, whether it achieved this explicitly or implicitly was to build the need if not exclusively then in very large part based on scare tactics around the fitness of New Zealand tap water and I am clearly of the view that the architect of that approach was Mr Smart.

[11] Mr Lloyd has submitted to me today that I did not come to that position in the judgment I gave. The issue in that judgment was whether Mr Smart was a party or a secondary party as the term is often used in terms of s 66(1) Crimes Act 1961. He did not personally make the misrepresentations, and there were a number of dynamic factors that went into how those representations were made.

[12] What I did find was that the defendant knew of, approved, and encouraged the training techniques adopted in New Zealand which were designed and did produce misrepresentations in the sale of Love Springs' water filters and that he knew of, approved, and encouraged the use of misleading sales brochures and thereby aiding and encouraged the respective conduct that was liable to mislead.

[13] I am of the view that in this offending viewed globally, Mr Smart's culpability is high. He is, I have no doubt, amongst a team of sales people, a quite charismatic figure. He was described as larger than life, colourful, flamboyant, and the like. I have no doubt that his opinion or what the sales representatives viewed as

his opinion would have carried huge weight with them and I simply refer to the various other findings that I made in my judgment of 4 October 2013.

[14] Mr Lloyd is quite right to point out that we do not know just to what extent the misrepresentations were causative of sales, or causative of sales at what level maybe another way of expressing it. But we do know sufficient for the purposes of sentencing. In my view the representations were widespread and they were an important part of Love Springs' marketing campaign. Those misrepresentations were critical in persuading people why what was free from a tap should be replaced by a $1600 water filter.

[15] I, in the course of hearing submissions, stated to counsel that in my view it is not my role to embark upon any tariff sentencing or to set what are appropriate sentencing levels. All I can do is set or come to a sentence on the facts on the merits of this case. However, the High Court on more than one occasion has said that this legislation has to have teeth. It is deterrent legislation, it is there to protect consumers and it is there to create a level playing field for competitors.

[16] In this case, in my view, it was deliberate commercial offending taking a conscious commercial risk for which there must be a commercial penalty. Having said that, that penalty still has to be consistent with other cases insofar as they are relevant and can provide guidance in this unique situation.

[17] Referring to the now well accepted criteria to be applied in cases such as this, the first is the objectives of the Act. The offending here strikes at the core of what this Act is designed to prevent. The second is the importance of the un-true statement which was made or published. The untrue statements which were made here were very important. Tap water is virtually omnipresent in New Zealand homes. As was conceded or acknowledged by both counsel in submissions, health concerns are a community-wide concern.

[18] Attacking the safety of people's tap water and creating fears about it and, in some cases, very grave fears, is highly pertinent to this sentencing exercise. It creates a high degree of culpability for both Love Springs and Mr Smart. Mr Dixon

is correct to point out that this aspect of the offending distinguishes this case from all the other cases which provide guidance. It was negative advertising about something which is present in virtually everybody's daily life. In that way it can be distinguished from cases such as *Zenith Corporation Ltd v Commerce Commission* HC Auckland CRI-2006-404-000245, 27 May 2008 and *Ecoworld* which simply set out to make positive but albeit false claims about the defendant's product.

[19] The third of the criteria is the degree of culpability in the context of wilfulness or carelessness which will generally involve a consideration of the circumstances in which the statement was made or published; in this case, as I have said, I have found that the misrepresentations here were a part of a conscious strategy about how these products were to be sold and that was achieved both explicitly and implicitly. It did not have to be achieved explicitly when trainees were directed to websites to conduct research which the trainers knew would produce text or commentary raising these sort of fears or scares about tap water.

[20] That then linked into how to build the need or linked into the company's sales strategy, linked in to how sales representatives were remunerated in my view was always going to produce the high risk that people would sell in this way. Mr Lloyd is quite correct to point out that not all sales representatives did sell in this way. But, in my view, a significant number must have given the high level of compliance, the way in which people were trained and the evidence which I accept that these scare tactics played a large part of the training programme.

[21] The fourth of the criteria is the extent to which the statement departed from the truth. Well, it departed very significantly because, for all intents and purposes, New Zealand tap water is safe.

[22] The fifth of the criteria, the extent of dissemination of the statement; these misrepresentations were not made on national radio or national TV. They did not have to be because the method of selling was door-to-door. Having used the sales techniques of breaking the ice and such other matters that the trainees were encouraged to use, they then engaged people at home, mostly during the day, and a discussion on the desirability of purchasing a Love Springs' water filter.

[23] Mr Dixon describes that method of selling, I think, as high pressure and it is a method of dissemination which I do not believe is present in the other relevant cases. While it does not have the dissemination that might have been present in a case such as *Zenith*, it is nevertheless very effective dissemination and the fact that 12,000 contracts were at one point signed, (although I accept ultimately nowhere near that number were ultimately honoured), it demonstrates the extent of the dissemination of the misrepresentations. I do again remind myself though that, on not all occasions, would these misrepresentations have been made.

[24] The sixth of the criteria is the extent of prejudice or harm to consumers or other traders which resulted from the statement. The defendants say that the product is nevertheless valuable and it has its own worth. I accept that it did not need to be sold in the way that it was sold on these occasions. I accept that in compliance with the Act the water filters are still being marketed successfully.

[25] However, if those representations were made, and it may be difficult to know just how much or to what extent consumers placed reliance on them; it would be a moot point as to what extent people would subsequently have admitted or would admit to having undertaken or engaged in a course of conduct based on misunderstanding and admit their error.

[26] The next factor is the attitude of the offender in respect of remorse, co-operation with the authorities and remedial action in respect of corrections. I have already found that this sales strategy was deliberate. In the period of the offending there was no mitigation or there were no steps to remediate and, in fact, the Commission had to take injunction proceedings in the High Court to restrain Love Springs from such conduct.

[27] Broadly the steps taken by Love Springs subsequently can be seen to be ones that should have always been in place and I am not prepared to regard the steps in that regard as mitigating factors.

[28] The next of the criteria is the importance of deterrence both particular and general. There is a real need to deter traders in New Zealand from trading in this

way and that is trading door-to-door, face-to-face, people at home relying on misrepresentations concerning their health.

[29] The next factor is the financial circumstances of the offender and there was an amount of discussion about this. There was no evidence before me that either the company or Mr Smart do not have the means to pay the sort of fines that are being discussed and it is common ground between the parties that the revenues from the sale of these filters in the relevant period was around 3.6 to 3.8 million.

[30] The next of the criteria is guilty pleas; the company is clearly entitled to material discount for that and Mr Smart not so.

[31] The next is the previous record of the offender; as I advised counsel I am not prepared to regard the events of Queensland as requiring an uplift to any starting point here because that fact played a part in the determination of the deliberateness or the wilfulness of the conduct.

[32] The last matter is the effect of any publicity regarding the prosecution and/or the defendant's activities; while there has been publicity regarding this matter, as I have already referred to, I do not see that as bearing upon sentencing or the appropriate penalty to be provided.

[33] I should add for completeness that my understanding of the position of the parties regarding s 40(2) of the Act is that the representative nature of the charges that Love Springs faces, spread over the period of time of each of the charges, is such that s 40(2) does not come into play and, in my view, the same logic must apply to the charges that Mr Smart faces.

[34] I have found it extremely difficult to isolate one case which provides really meaningful guidance. There has been much focus on the decisions in *Zenith* and *Ecoworld.* What makes *Zenith* a little bit difficult to apply in this case is that uniquely to *Zenith's* own facts, the sentencing Judge grouped the offending by category of media by which the misrepresentations were made and then applied penalties accordingly.

[35] In the High Court, Andrews J said this:

> While the placement of an offence on the scale from most serious to least serious must to a large extent be a matter of a Judge's own assessment, it is difficult to see how the misrepresentations that were the subject of these charges could be seen as the most serious that could occur. In the circumstances I have concluded that the appropriate penalty on the basis of the Judge's assessment of the seriousness would have been a fine of $65,000, and that is two-thirds of the maximum, which then would be adjusted to allow for the corrective advertising and cost orders. As a consequence the balance of the fines imposed, including those imposed for the labelling charges should also be adjusted to approximately two-thirds of that imposed.

[36] It is not in my view possible to gain further guidance from the High Court decision in *Zenith* as to the approach here than that.

[37] I again repeat that I also consider the circumstances here significantly different from *Zenith*, in terms that the negative or the health scare claims made about tap water in this case are not present in *Zenith*. *Ecoworld* has been referred to as discussed with counsel. I am of the view that the assistance of that case is limited. It was under the old regime and at paragraphs 10, 11 and 12 of the judgment the learned District Court Judge sets out the approach that she adopted and how that was influenced by the view that the Commission took in that case.

[38] So while I will have an appendix of all of the cases that have been referred to, and which I have considered, attached to the judgment, it really serves no useful purpose to trawl through them now and do case summaries of them. This case falls to be determined by the legislative framework, by the criteria that I have referred to and by the sentencing principles set out in the Sentencing Act 2002. Clearly deterrence must play a significant part.

[39] Mr Dixon's submissions today have focussed on the matters, or the matters he focussed on have been really covered in the assessment of the criteria that I have gone through. Mr Lloyd makes a number of submissions. He says that the Commission has over reached, that its starting points cannot be justified, and that the doubling of the penalty in this case to that which applied in *Zenith* and *Ecoworld* or doubling in the maximum penalty available should not equate to a doubling of starting points and he is right in that regard.

[40] He, consistently with the position for the defendants throughout has made submissions that the offending should not be seen as systematic or deliberate or wilful or part of a design or strategy. I have found against him on that. He quite rightly points out, and which Mr Dixon accepts, that there must not be double-counting in respect of the penalties to be applied to the company and to Mr Smart.

[41] The Commission submits that starting point for Love Springs should be in the order of $600,000 with a discount of 15 percent for guilty pleas arriving at an end sentence of approximately $510,000. That the starting point for Mr Smart should be around $225,000 with no discount because there are no mitigating factors, and the penalty to be imposed for the s 47J matter which I will come to separately.

[42] In terms of the Fair Trading Act, s 10 matters, my view is that if matters had stood on their own a penalty of a $500,000 starting point for the company may be appropriate or if Mr Smart had stood trial on his own, a starting point for him of some $200,000 would be appropriate.

[43] Viewed overall, my view is that a $700,000 starting point for this offending would be too high and that a starting point of $600,000 represents the global culpability. As I have said, I regard Mr Smart's culpability as high because I regard him as the architect of the offending.

[44] In those circumstances what I propose to do is set the penalty in relation to him at $200,000 and, in relation to the company, I reduce that to $400,000 on a totality or global basis. Therefore in relation to the company I apply a 15 percent discount for the guilty plea which brings me to a figure of $340,000.

[45] The way I propose to deal with matters is apportion that equally across the 11 offences and dividing that by 11, the penalty for each information on Love Springs will be $30,900. In respect of the seven charges that Mr Smart faces, that figure of $200,000 will be divided by seven and apportioned as $28,500 per information.

[46] With respect to the s 27J charge, that was material. Probative evidence was withheld initially from the Commission. It is an offence which has a maximum penalty of $30,000. I accept the starting point there as $20,000 but, in the circumstances, I will allow a 25 percent discount and the ultimate fine there will be one of $15,000.

R Collins
District Court Judge