

13 October 2016

Melissa Lee MP  
Chairperson  
Commerce Committee  
Private Bag 18041  
Wellington 6160

Dear Ms Lee

**Commerce Commission submission on the Consumer Guarantees (Removal of Unrelated Party Lender Responsibility) Amendment Bill**

1. We welcome the opportunity to submit on the amendment to the definition of supplier in the Consumer Guarantees Act 1993 ('the CGA').

**The Commission's views**

2. The question of whether the definition of supplier in the CGA should be amended to remove unrelated party lender responsibility is ultimately a matter of policy. However, the Commission makes the following observations:
  - 2.1 The current definition of supplier provides a level of consumer protection that is consistent with the purpose of the CGA and with recent legislative amendments that strengthen consumer protection under the Credit Contracts and Consumer Finance Act 2003 ('the CCCFA'), the Fair Trading Act 1986 ('the FTA') and the CGA. It appears inconsistent with these strengthened consumer protections to reduce the long standing protection provided by the CGA in the manner proposed by the Bill.
  - 2.2 The purposes of the CGA are more likely to be achieved by making a lender responsible for the CGA guarantees in the circumstances set out by the CGA. In many ways, the lender's interests in ensuring that secured goods meet CGA guarantees are more aligned with the borrower than the vendor. For example, both the borrower and the lender have an on-going financial interest in ensuring that goods purchased and provided as security for a loan are delivered and are of acceptable quality.
  - 2.3 In the Commission's experience, vendors who arrange finance for consumers usually have a mutually beneficial arrangement with the lender, whether or not they are "related" to each other. In these circumstances, we do not consider it is disproportionate for the lender to bear CGA responsibilities for goods secured by the loan.

- 2.4 We think that consumers are unlikely to know whether the lender and vendor are related, and this may affect their ability to avail themselves of any rights they have against related lenders, particularly because consumers must enforce their own rights under the CGA.
- 2.5 If the Committee supports the Bill, we recommend amending the wording so as to remove reference to an accounting standard, and replace this with a legislatively-defined ‘related party’. We consider that this will make enforcement of the Bill easier, as it would provide more certainty and clarity. We suggest that the Committee consider the definition of “associated person” in the CCCFA or the Income Tax Act 2007.

### **Interface between the Commission’s enforcement responsibilities and CGA**

3. The Commission is responsible for enforcing the FTA and the CCCFA, and is familiar with the context within which this Bill is to be considered. For example:
- 3.1 The Commission investigates false or misleading representations made by traders about their obligations under the CGA, as such representations are prohibited by section 13(i) of the FTA. Under the FTA, the Commission is also responsible for enforcing provisions relating to extended warranties that require traders to compare CGA rights with those offered under extended warranties.
- 3.2 The Commission enforces the CCCFA which now includes the Responsible Lending Provisions. Section 9C(3)(f) of the CCCFA states that a lender must meet all legal obligations to the borrower, including those set out by the CGA.

### **Status quo is consistent with consumer protection**

4. The current definition of supplier gives the consumer extended rights of redress in certain circumstances, providing increased protection. Consumers are able to seek redress against both the vendor and lender, where the goods were acquired using credit arranged through the supplier of the goods, and the loan is secured against the goods.
5. Recourse to the lender – even where that lender is not a “related party” (as defined) to the supplier – has the following implications:
- 5.1 Lenders are likely to be incentivised to take action to ensure that suppliers comply with their CGA obligations to protect their security. If defective goods are not repaired, replaced, or a refund is not made to enable a consumer to repay the loan, a lender’s security is placed at risk. This incentive is enhanced if they are directly liable to the consumer if the goods fail to meet the CGA guarantees.
- 5.2 Lenders may also be in a position to proactively mitigate any risk to themselves by undertaking due diligence on the suppliers whose goods they

are prepared to finance. For example, in anticipation of liability of this kind, a lender can take steps to offer finance only for goods it considers are likely to be of acceptable quality, and/or supplied by suppliers that it considers are likely to honour their CGA obligations to consumers who are also to become the lender's clients.

- 5.3 Consumers may be more likely and/or better able to pursue a remedy against a lender with the current statutory protection in place. Disputes Tribunal or Court proceedings may also be necessary against a reluctant lender. However, the consumer may have a more effective negotiating position against the lender because if the lender fails to comply with its obligations under the CGA, this may affect its ability to enforce the loan against the consumer.<sup>1</sup> The consumer is unlikely to have similar negotiating power in discussions with the supplier of the goods who has no other ongoing relationship with the consumer.
- 5.4 Lenders can also ensure they are indemnified for any remedies provided to consumers for CGA breaches. Lenders could also negotiate a guarantee from directors of the supplier, in the event of supplier insolvency.
- 5.5 Lenders may be better placed than consumers to pursue a remedy and/or negotiate a suitable remedy with non-compliant suppliers of goods. For example, lenders could threaten to withdraw the availability of financing facilities to the suppliers' customers, or refuse to pay commissions which might be payable to the supplier in respect of loans it arranges for goods which are defective.

### **Status quo consistent with purposes of the Act and strengthened consumer protection**

6. Extended rights of consumer protection are consistent with the purpose of the CGA which was inserted in 2013.<sup>2</sup>

#### 1A Purpose

(1) The purpose of this Act is to contribute to a trading environment in which—

- (a) the interests of consumers are protected; and
- (b) businesses compete effectively; and
- (c) consumers and businesses participate confidently.

(2) To this end, the Act provides that consumers have—

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<sup>1</sup> For example, if the lender issued proceedings against the consumer to enforce the loan, the consumer might be able to raise a right of set-off in respect of any liquidated amount the lender owes it pursuant to the CGA, against the amounts owing pursuant to the loan.

<sup>2</sup> Consumer Guarantees Amendment Act 2013.

(a) certain guarantees when acquiring goods or services from a supplier, including—

(i) that the goods are reasonably safe and fit for purpose and are otherwise of an acceptable quality; and

(ii) that the services are carried out with reasonable care and skill; and

(b) certain rights of redress against suppliers and manufacturers if goods or services fail to comply with a guarantee.

7. We also note that there have been amendments to the FTA and CCCFA in recent years that are consistent with strengthened consumer protection. These amendments include the introduction of the Responsible Lending Provisions and an increase in penalties under the FTA and CCCFA.

### **The Bill will remove consumer protection**

8. Changing the definition of a supplier as proposed in the Bill narrows the circumstances in which lenders will be responsible for meeting consumer guarantees, and reduces the scope of protection provided to consumers who acquire secured consumer goods on credit under the *status quo*.
9. It is also worth noting that the effect of this Bill will not be limited to loans secured over non-essential consumer goods. All goods subject to a purchase money security interest will be caught. Under s83ZN(2) of the CCCFA, a lender can take a purchase money security interest over essential goods – for example, stoves, fridges, medical equipment and washing machines.
10. If the Bill is enacted, it may lead to circumstances where a consumer:
- 10.1 has goods which are defective (in breach of the CGA), where the supplier is failing and/or refusing and/or unable to meet their obligations under the CGA to repair or replace the goods or refund the purchase price;
  - 10.2 is still liable to the lender to repay a loan taken to pay the purchase price of those goods<sup>3</sup>; and
  - 10.3 may need to replace the goods (which could require the consumer to obtain further finance to do so).
11. The Bill, if enacted, leaves the consumer with two avenues of recourse where a supplier is failing and/or refusing to meet its obligations to the consumer under the CGA:

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<sup>3</sup> The CCCFA does not give a consumer the right to cancel a loan simply because the vendor has not met its obligations under the CGA.

- 11.1 commence proceedings in the Disputes Tribunal or Courts, seeking orders that require the supplier to meet its obligations under the CGA and ensure that the consumer is provided with repaired or replacement goods or a refund; or
  - 11.2 commence proceedings in the Disputes Tribunal or Courts pursuant to section 23A of the CGA seeking an order that the consumer's obligations pursuant to the loan agreement vest in the supplier, so that the consumer is not left paying for defective goods.
12. Whether these are sufficient mechanisms for protecting consumers is a matter for Parliament. However, in our experience, many consumers find commencing proceedings in the Disputes Tribunal or Courts a burdensome and potentially intimidating process. Many consumers may choose not to enforce their legal rights through the Disputes Tribunal or Courts. Direct recourse to lenders provides an additional means of protection for consumers.
  13. We also note that it is likely to be difficult for consumers to know whether a lender and vendor are related, and this could be problematic for self-enforcing legislation. Consumers may have access to information from the Companies Office which may establish ownership or control, but they are unlikely to have access to information that would enable them to show that one entity has "significant influence" over the other. It may be that the practical effect of this legislation is to remove lender liability altogether.
  14. The Commission understands lenders' concerns that where the supplier is insolvent, a lender who has made payments in respect of a consumer's claim under the CGA will be unable to recover those payments from the supplier, and will ultimately be left out of pocket. However, the Bill does not resolve this issue – it simply shifts the burden of the loss in an insolvency situation from the lender to the consumer.

### **Mutually beneficial relationships**

15. In the Commission's experience, most vendors who arrange loans for the purchase of goods have a mutually beneficial relationship with the lender – whether contractual or otherwise.
16. For example, there are many situations where a lender will agree to provide finance to "associated dealers" but where the lender will not necessarily have "significant influence" over the dealer.<sup>4</sup> In these circumstances, the lender does have the ability to influence the vendor, or to seek recourse from them for breaches of the CGA, but would be excluded from CGA liability under the proposed amendment.

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<sup>4</sup> For example, this is the nature of the relationship between Sportzone and MTF.

**Definition of “related parties”**

17. If the Committee supports the Bill, we suggest that it does not adopt the proposed definition of “supplier”.
18. The proposed new definition of supplier references an accounting standard at section 2(1)(b)(ii)(C): “the creditor and that person are related parties in terms NZ IAS 24”.
  - 18.1 This is likely to create uncertainty for borrowers and lenders as well as legislative difficulties, as presumably the accounting standard can be amended or withdrawn.
  - 18.2 Such a definition would introduce a new layer of complexity into consumer laws. The CCCFA, for example, already contains a definition of an “associated person”. It would potentially create confusion for borrowers if a lender and a vendor were “associated persons” for the purposes of the CCCFA but not “related parties” under the standard.
19. If the Bill was to be passed, the Commission recommends that the wording be replaced with a legislatively defined ‘related party’. This would provide more certainty and clarity from an enforcement perspective. This is especially important for consumers who must take enforcement action under the CGA on their own account. We recommend that the Committee consider referencing the definition of “associated person” in the CCCFA, or considering a wider statutory definition such as the one contained in the Income Tax Act 2003.
20. We have attached examples of how the provisions work currently, and how they may work if the Bill is passed, which may be of assistance.

Yours sincerely



Anna Rawlings  
Commissioner

## Attachment A

### Examples of remedies available to consumers with and without the proposed amendment

1. The current definition of supplier allows consumers to seek redress against both the vendor and lender, where the goods were acquired using credit arranged through the vendor of the goods, and the loan is secured against the goods. The Bill proposes removing lender liability in cases where the lender and vendor are not related. The impact of the change on an affected consumer can be illustrated using the following examples.

#### *Example one*

2. A consumer purchases a car for \$5,000 from Car Company Limited. It is financed through lending with Car Loans Limited – the finance was arranged for the consumer by Car Company. Car Company and Car Loans have a mutually beneficial arrangement which does not amount to them being related, but does incentivise their relationship. Car Company operates as a thinly capitalised shell company. It ceases to trade, although another company is formed and continues to trade from the same premises using the same trading name. The car turns out to be not of an acceptable quality – in breach of the CGA.
3. Under the current terms of the CGA:
  - 3.1 The consumer would have recourse to the lender for a remedy when the vehicle proves defective, even though Car Company is no longer trading and can not meet its obligations to the consumer. The lender is incentivised to undertake due diligence and to interact with dealers who fulfil their obligations under the CGA.
4. The consumer has little or no ability under the Bill's proposed changes to enforce their CGA rights.

#### *Example two*

5. The consumer purchases a fridge for \$3,000 from Best Fridges Limited. It is financed through lending with Fridge Loans Limited – the finance was arranged for the consumer by Best Fridges. Fridge Loans is unrelated to Best Fridges. The fridge fails to work and therefore is in breach of the guarantees under the CGA (i.e. is a breach of a substantial character).
6. Under the current terms of the CGA:
  - 6.1 Pursuant to the current terms of the CGA, the consumer has a legal right to reject the goods and seek refund of the \$3,000 paid for the goods from either Best Fridges or Fridge Loans. The effect of a refund from Fridge Loans would be to repay or credit back the loan, so the consumer is not left owing money on defunct goods.

- 6.2 If Best Fridges cannot/will not/does not meet its obligations under the CGA or fails to do so promptly, the consumer can seek the refund from Fridge Loans and be restored to the position they were in before acquiring the fridge.
  - 6.3 If Fridge Loans is required to refund the consumer under the CGA, it will likely have a legal right against Best Fridges for reimbursement. It may have negotiated a contractual right of that nature before agreeing to offer finance through Best Ridges. Fridge Loans may also be in a better position to commercially negotiate resolution of the matter with Best Fridges. It may also choose to reconsider whether it is prepared to finance the purchase of secured consumer goods through a supplier which does not comply with its obligations under the CGA.
7. Under the terms of the Bill the consumer can only seek a refund from Best Fridges and must take action through the Disputes Tribunal or Courts if Best Fridges does not comply with its obligations.