

30 May 2014

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Credit Contracts and Consumer Finance Act 2003 / Fair Trading Act 1986: Warning

1. The Commerce Commission has been investigating Glaister Ennor Solicitors Nominee Company Limited (GESNC) under the Credit Contracts and Consumer Finance Act 2003 (CCCFA) and the Fair Trading Act 1986 (FTA). We have now completed our investigation and are writing to you to alert you to our concerns.
2. In summary, in relation to two loans to C S and S D Bassett, the Commission considers that GESNC has likely breached the following sections of the CCCFA:
 - 2.1 section 38, which prohibits the early payment of interest charges;
 - 2.2 section 39, which constrains the methods that can be used to calculate interest charges;
 - 2.3 section 40, which provides that default interest can be charged only during the period of default;
 - 2.4 section 41, which provides that credit and default fees must be reasonable; and
 - 2.5 section 50, which provides that a debtor has the right to make full prepayment of the loan at any time and a consumer credit contract must not prohibit full prepayment.
3. In addition, we also consider that GESNC has likely breached section 13(i) of the FTA, which prohibits the making of false or misleading representations concerning the existence or effect of a condition or right.
4. We have taken GESNC's explanations into account in forming our views. We also note your advice that GESNC has decided to cease making loans to natural persons for personal, domestic and household purposes, and will therefore no longer enter into consumer credit contracts.

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The investigation

5. During our investigation, the Commission considered information on loans GESNC had made to natural persons between March 2010 and April 2013. Of these, only two were consumer credit contracts – a loan to C S and S D Bassett of \$565,000 dated 12 May 2010, and a loan of \$585,000 to the same couple when the loan was rolled over one year later.
6. The loan documents were reviewed and the following potential breaches were identified.

Section 38: Early debit or payment of interest charges prohibited

7. In our opinion, GESNC has charged interest in advance. This is prohibited by section 38 of the CCCFA. The purpose of section 38 is to ensure that the debtor does not have to pay interest before it is due.
8. Section 38 of the CCCFA states:
 - (1) A creditor must not, at any time before the end of a day to which an interest charge applies, require payment of or debit the interest charge.
 - (2) A consumer credit contract may provide for an interest charge to become payable or to be debited at any time after the day to which it applies.
9. GESNC's letter of offer states:

Mortgage interest will commence on the date we have all contributors' authorities whether or not there are other conditions to satisfy.
10. Clause 40 of the first Basset contract states that:

Twelve months interest is to be deducted from the principal sum and retained by the Mortgagee to be applied in payment of interest on the Interest dates.
11. The sum of \$52,150 was subsequently added to the loan, and then borrowed from GESNC and paid to Glaister Ennor to be applied as interest on a monthly basis over the term of the loan. In our opinion, this conduct is contrary to section 38 of the CCCFA.
12. It also appears to breach section 13(i) of the FTA, which prohibits the making of false or misleading representations concerning the effect of any right (in this case, the debtor's right not to pay interest except in arrears).

Section 39: Limit on interest charges / Section 40: Default interest charges

13. In our opinion, GESNC's contracts provide for interest in excess of that for which it is legally entitled to charge.
14. Section 39 of the CCCFA states:
 - (1) The maximum amount of an interest charge that may be imposed or provided for under a consumer credit contract is, -

- (a) in the case of 1 annual interest rate applying to the unpaid balances under the contract, the amount determined by applying the daily interest rate to the unpaid daily balances; or
 - (b) in any other case, the sum of each of the amounts determined by applying each daily interest rate to that part of the unpaid daily balances that applies to under the contract
15. The point of this provision is to ensure that debtors get the full benefit of payments they make from the date of payment – creditors cannot charge interest for a period based on the unpaid balance at the beginning or end of the period.
 16. Section 40 of the CCCFA permits a creditor to apply a higher interest rate where the debtor has defaulted in payment or has exceeded a credit limit. However, the higher rate may be charged only during the period of the default or excess.
 17. GESNC's letter to the Bassetts states:

On early repayment you must also pay one month's bonus interest. If you fail to repay the principal sum on the due date an additional one month's interest is also payable (in addition to any other penalties payable).
 18. The Bassett contracts then include further clauses specifying when "bonus" interest is payable:
 - 18.1 in the case of full prepayment, clause 31.1 provides that GESNC can charge "interest to the date [specified in the notice for prepayment] and interest for a further period of one month after the date so specified"; and
 - 18.2 in the case of late payment, clause 33.1 provides that GESNC can charge "interest calculated on the principal sum as to the ordinary interest rate for a period of one month, in addition to all interest and other moneys otherwise payable".
 19. Clause 31.1 appears to be contrary to section 39, while clause 33.1 appears to be contrary to both sections 39 and 40. In addition, the misstatement of the Bassetts' rights is likely in breach of section 13(i) of the FTA.

Section 41: Unreasonable credit fee or default fee

20. In our opinion, GESNC's contract with the Bassetts includes unreasonable fees. If a consumer credit contract includes unreasonable fees, it breaches section 41 of the CCCFA.
21. Section 41 of the CCCFA requires fees charged on consumer credit contracts to be reasonable. Section 42 provides that, when determining whether an establishment fee is reasonable, the court must have regard to the creditor's reasonable costs.
22. Section 44 provides that, when determining whether a credit fee (other than an establishment or a prepayment fee) or a default fee is reasonable, the court must have regard to:

- 22.1 whether the fee reasonably compensates the creditor for its costs or losses; and
- 22.2 reasonable standards of commercial practice.
23. The GESNC contracts provide for fees of \$28,215 in respect of a loan of \$565,000 for 19 months.
24. We note that commercial practice is not a factor a court is required to take into consideration when considering reasonableness of an establishment fee.
25. GESNC does not, itself, incur any costs. Therefore, as the cost recovery must relate to the creditor and its costs, because GESNC incurs no costs, it is possible that a court may take the view that the fee is wholly unreasonable.
26. However, even if we disregard this point and look through GESNC to costs incurred by Glaister Ennor, we do not consider that the fees charged are reasonable. An establishment fee, in particular, only permits a creditor to recover a very narrow category of costs.
27. We reached this view based on information provided by GESNC which included the high number of hours taken by Glaister Ennor staff and partners to establish the loan, and the high costs of Glaister Ennor staff time. We requested GESNC provide further information about the work undertaken, but it declined to do so.
28. It is our opinion that a creditor's recoverable costs do not include profit or most overheads. However, these costs would automatically be recovered if a legal firm's charge out rate was used as the basis for cost. We sought information from you to justify the fee, including the number of hours claimed to have been spent by Glaister Ennor. GESNC has declined to provide evidence to show that this amount of time was, in fact, spent on this loan.
29. As stated in *Commerce Commission v Sportzone Motorcycles Limited (in liquidation) and others*,¹ "the evidential onus of disproving unreasonableness which might be established prima facie is likely to fall on the lender which is in possession of all of the relevant information." The Commission is of the view that GESNC has not disproved unreasonableness.

Section 50: Debtor's right to full prepayment

30. In our opinion, GESNC has breached section 50 of the CCCFA by including a contractual term prohibiting the debtor's statutory right to prepayment.
31. Section 50 of the CCCFA states:
- (1) A creditor must accept any full prepayment of a consumer credit contract from a debtor at any time.
 - (2) The full prepayment must be credited in accordance with section 46(1).

¹ [2013] NZHC 2531.

(3) A consumer credit contract must not prohibit the full prepayment of the contract

32. The loan offer letters for the Bassett loans state:

There is no right to repay part only of the principal sum during the term of the mortgage. You do however have the right to repay the whole of the principal sum at any time after the first three months of the term.

33. The loan contracts state that:

The Mortgagor will pay the principal sum to the Mortgagee in one sum on the Term expiry date provided however that the Mortgagor shall be entitled at any time after the expiry of three months from the Interest commencement date and after giving not less than one months' notice in writing of the Mortgagor's intention so to repay ... to repay the principal sum in full upon the date specified in such notice

34. We consider that GESNC's representations in the contract about the debtor's right to prepayment are also likely to breach section 13(i) of the FTA.

Warning

35. For the reasons set out above, the Commission's view is that GESNC's conduct is likely to have breached the CCCFA and FTA. In the circumstances, we have decided to issue this warning.

36. While we will not be taking any further action against GESNC at this time, we will take this warning into account if this conduct continues or if you engage in similar conduct in the future. We may also draw this warning to the attention of a court in any subsequent proceedings brought by the Commission against GESNC.

37. This warning letter is public information and will be published on our website. We may also make public comment about our investigations and conclusions, including issuing a media release or making comment to media.

Penalties for breaching the CCCFA and FTA

38. Only the courts can decide if there has actually been a breach of the legislation we enforce. The court can impose penalties where it finds the law has been broken. Credit providers who breach the CCCFA may:

38.1 be unable to enforce the contract or any right to recover property or any security interest

38.2 have to refund money or pay compensation

38.3 have to pay statutory damages

38.4 be convicted of a criminal offence and fined up to \$30,000 per offence

38.5 have contracts changed by the court if the contracts are oppressive

38.6 be banned from operating within the finance industry.

39. A company that breaches the FTA can be fined up to \$200,000 and an individual up to \$60,000 per offence.
40. You should be aware that our decision to issue this warning letter does not prevent any other person or entity from taking private action through the courts.

Further information

41. We have published a series of fact sheets and other resources to help businesses comply with the CCCFA and FTA and the other legislation we enforce. These are available on our website at www.comcom.govt.nz.
42. Thank you for your assistance with this investigation. Please contact me on 09 919 4441 or by email to john.lyall@comcom.govt.nz if you have any questions in relation to this letter.

Yours sincerely



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