IN THE DISTRICT COURT
AT AUCKLAND

CRI-2007-004-010204
CRI-2007-004-010936

COMMERCE COMMISSION
Informant

v

AVANTI FINANCE LIMITED
Defendant

Hearing: 19, 20, 21, 22 and 29 May 2008

Appearances: D Marshall and A McClintock for informant
J Miles QC, M J Brown and I Denton for defendant

Judgment: 10 June 2008

RESERVED JUDGMENT OF JUDGE A E KIERNAN

INTRODUCTION

[1] Avanti Finance Ltd charges its debtors a fee if the unpaid balance of a credit contract is paid before the final payment under the contract is due. This fee is calculated according to a formula set out in each credit contract.

[2] The Commerce Commission alleges that the prepayment formula used by Avanti is not a reasonable estimate of its loss and therefore does not comply with the Credit Contracts and Consumer Finance Act 2003.

[3] The Commerce Commission also alleges that part of the wording used by Avanti in the contract clause relating to full prepayment is misleading and therefore in breach of the Fair Trading Act 1986.

[4] Avanti Finance Ltd maintains that its formula for calculating costs on full prepayment is a reasonable estimate of its loss, and also maintains that the wording of its contract is not misleading.

BACKGROUND FACTS

[5] Finance companies are an essential part of modern life. They offer credit to enable borrowers (debtors) to buy houses, cars and smaller items. Money is advanced on contract terms which include interest payments. The debtor agrees to pay back the loan at a particular rate over a set period of time. A finance rate is agreed at the beginning of the credit advance. It is a high risk business and loans are often made at high interest rates.

[6] Such finance arrangements are now regulated by the Credit Contracts and Consumer Finance Act 2003 ("CCCF Act") and the 2004 Regulations made under that Act. Fair trading practices in the market place are regulated by the Fair Trading Act 1986.

[7] Avanti Finance Ltd is a company which has offered consumer credit for many years. Loans have generally been for amounts between $1,000 and $30,000. One of the standard conditions in the company's contracts with its debtors sets out the conditions for early prepayment of a loan. There is a formula set out in each credit contract which specifies the way in which a sum due by a debtor who wishes to make full prepayment of the loan is calculated.

[8] The CCCF Act provides that debtors have a right to make full prepayment under a consumer credit contract at any time (s.50). The finance company may suffer a loss if there is early repayment of the loan, and the law recognises that the finance company (the creditor) can impose a fee or charge on the debtor for early prepayment. The creditor is required to calculate a reasonable estimate of its loss using a procedure prescribed under the Regulations made under the Act, or an appropriate procedure set out in the credit contract (s.54).

[9] The Regulations provide for what has become known as a 'safe harbour' formula for calculating the fee or charge on full prepayment. If this 'safe harbour' formula is used by the finance company, then the law provides that the prepayment fee charged will be treated as reasonable. The safe harbour formula for calculation of reasonable estimate of creditor's loss if the interest rate of the loan is fixed for the whole term is set out in Regulation 9. This is attached as Appendix A to this decision.

[10] If the finance company chooses not to use the Regulation 9 formula and to calculate its loss in another way, then the fee or charge will be regarded as unreasonable "if, and only if, it exceeds a reasonable estimate of the creditor's loss arising from the full prepayment as calculated in accordance with s.54" (s.43(2)).

THE CHARGES

[11] The Commerce Commission has prosecuted the defendant company in relation to 50 particular credit contracts which were each terminated before the contract end date by the debtors choosing to make full prepayment of the loan to Avanti Finance Ltd. The dates on which the contracts were fully prepaid cover an

eighteen month period from June 2005 to December 2006. Appendix B to this decision is a schedule which I have made to set out details from the 50 credit contracts of amounts of loans, interest rates, time of prepayment etc. Those details have been obtained from the evidence including Exhibit 19 in particular. Exhibit 19 is the 50 Avanti finance contracts subject of this hearing.

[12] The informant has charged the company with 50 criminal offences under s.51 of the CCCF Act in respect of each of these contracts alleging that the company "being a creditor under a consumer credit contract required an amount for the full prepayment of a consumer credit contract that exceeded the sum provided for under the Act". The 50 consumer credit contracts subject of this hearing are all fixed term and fixed interest rate contracts. They vary in loan amount from $2,093.81 to $43,764.09 and in interest rate from 16%% to 25% with the majority being at 25%. Each of the 50 contracts was prepaid before the end of the loan term by the debtors. Those early prepayments ranged from 7 weeks to 239 weeks before the end of the loan term.

[13] The informant also brings charges under s.54 of the CCCF Act, in the alternative, in respect of each of the 50 contracts alleging that the company "being a creditor under a consumer credit contract calculated an unreasonable estimate of its loss arising from a full prepayment of the consumer credit contract".

[14] The Commerce Commission has also brought 50 charges against the defendant company under s.13(g) of the Fair Trading Act 1986 alleging that the company "being in trade, in connection with the supply or possible supply of services made a false or misleading representation concerning the price of any services", and in respect of each information it is alleged the misleading representation was "that full prepayment of the loan may incur a fee or charge to compensate the creditor from loss arising if the creditor's current interest rate is lower than the interest rate applying to the credit contract when in fact that was not the formula applied to full prepayment".

[15] In the alternative, the Commerce Commission has also laid 50 informations against the company in respect of each of the 50 contracts alleging breach of s.13(i)

of the Fair Trading Act 1986. The Commerce Commission alleges that, contrary to s.13(i) the company "being in trade, in connection with the supply or possible supply of services, made a false or misleading representation concerning the existence of a condition", the particulars being in each case that the company represented "that full prepayment of the loan may incur a fee or charge to compensate the creditor from loss arising if the creditor's current interest rate is lower than the interest rate applying to the credit contract when in fact that was not the formula applied to full prepayment".

[16] The charges brought under ss.51 and 54 of the CCCF Act are the first prosecutions under these sections which have gone to a hearing. There is no benchmark in terms of indication from any Court as to how those provisions should be interpreted. To that extent this is a test case, as stated by the parties at the hearing.

THE ISSUES

[17] There are two principal issues for determination in this case.

(1) Is Avanti's full prepayment formula a reasonable estimate of its loss?

(2) Is the wording of one sentence in its full prepayment clause a misleading representation?

THE COMPANY STRUCTURE

[18] Avanti is a finance company that operates in the non-bank lending market and is a relatively small financier. It offers a variety of loans including lending for motor vehicle purchase, debt consolidation, personal loans, second mortgages and interest only mortgages. In the past Avanti has traditionally provided loans for sums ranging from $1,000 to $30,000 but more recently the company has started to offer short term residential property loans, typically for less than one year.

[19] The companys' customers range from home owners with relatively low risk profiles to people with impaired credit histories. Interest rates are generally from 13% to 25%, and in relation to the majority of the loans the subject of the charges in this hearing averaged 20% to 25%. Brokers handle about 70% of Avanti's business with Avanti staff handling the balance. Of the broker business most of that comes through ten brokers well known to the company.

[20] Avanti obtains its funds from four sources – retained earnings, its shareholders, debentures and a bank facility.

[21] Avanti is a wholly owned subsidiary of G & S Investments Ltd, a private company controlled by Avanti's two directors, Stephen Eltringham and Glenn Hawkins. G & S also owns 100% of Galatos Finance Ltd. Galatos and Avanti have the same two directors, Mr Eltringham and Mr Hawkins. Galatos does not employ any staff or have an office premises, and essentially the business is run as one commercial enterprise, Avanti being the corporate vehicle for the business and Galatos the company which accesses bank funding, in accordance with the bank requirements. There is a generous bank facility with the ANZ National Bank. Interest on the loan facility is at the 90-day bank bill buy rate plus a margin of 1.9% per annum. An annual facility fee of 0.5% of the total facility is also paid.

[22] Avanti signs loan contracts with customers and advances the money under each loan. Those funds are advanced from Avanti's daily operating account and customers pay loan instalments to this bank account. That daily operating account does not have an overdraft facility, and no interest is earned on money in that account. Accordingly, the available bank facility through Galatos is drawn and repaid constantly to ensure that the amount in the Avanti daily operating account is kept as close to zero as possible.

[23] When Avanti requires funds beyond its own debenture funds and loan repayments it draws the money required from the Galatos bank facility. Galatos is therefore effectively Avanti's bank. A current account is run between Avanti and Galatos to record inter-company transactions including Avanti's drawing on the bank facility as and when needed. In order to balance the current account, Avanti

periodically sells loans it has written to Galatos at their book value at the beginning of the month. The number and value of the loans assigned is determined by the amount needed in order to zero the inter-company balance, the loans assigned to Galatos being its only assets. In fact, since March 2006 almost all of Avanti's loans have been assigned to Galatos, since Avanti wanted to grow its loan book using the bank facility rather than debenture funds.

THE AVANTI PREPAYMENT PROVISIONS

[24] In each of the 50 credit contracts the following clause appears under the heading "**FULL PREPAYMENT**":

> FULL PREPAYMENT
>
> If you pay the unpaid balance in full before the final payment is due (**full prepayment**), you may be required to pay a fee or charge to compensate the creditor for any loss resulting from the full prepayment. The creditor may have suffered a loss if the creditor's current interest rate is lower than the interest rate applying to your original consumer credit contract. You may also have to pay the creditor's administrative costs relating to the full prepayment.
>
> The amount you may have to pay to compensate the creditor for the loss is calculated using the following formula:
>
> $$CP = \frac{UB}{1} \times \frac{AR-(NB+1.9)}{100} \times \frac{90}{365}.$$
>
> where CP = Compensation payable
> UB = Unpaid balance
> AR = Annual interest rate shown in the interest section of this disclosure statement
> NB = ANZ National Bank 90 day bill rate previously set on the most recent of the following dates 01 January, 01 April, 01 July and 01 October
> If no such rate is available then the 90 day rate so set by any other major registered bank.
>
> NOTE – Should the period remaining on the contract be less than 90 days then the maximum compensation will be adjusted proportionally.

[25] This clause therefore sets out the formula which Avanti has chosen to use when any customer/debtor decides to make full prepayment on a credit contract.

The wording of this clause and the calculation it contains are the focus of this hearing.

THE STATUTORY SCHEME

[26] The Credit Contracts and Consumer Finance Act 2003 applies to every credit contract from 1 April 2005. It repealed the Hire Purchase Act 1971 and the Credit Contracts Act 1981.

[27] The Commerce Commission is the enforcing body. The Act is not a code. It sits alongside other statutes such as the Credit (Repossession) Act 1997 and contractual statutes such as the Contractual Mistakes Act 1977, as well as the general principles of contractual law.

[28] The purposes of the legislation are set out in s.3 and may be summarised as:

- Consumer protection.
- Rules for disclosure of adequate information.
- Rules about interest charges, fees and payments in relation to credit contracts.
- Allowance for changes to credit contracts in cases of unforeseen hardship.
- Regulation of buy-back of land transactions.
- To prevent oppressive credit agreements and oppressive conduct by creditors.

[29] The Act sets out a number of rules relating to part and full prepayment. A debtor is entitled to fully prepay under a credit contract at any time. An important aspect of the legislation is how a full prepayment should be calculated, and the legislature has chosen to set out a framework which ultimately relies on an interpretation of what is "reasonable" as far as an estimate of a creditor's loss is concerned when early prepayment is made.

[30] Regulations made under the Act set out a statutory formula which a creditor may use, and if the creditor does so, that formula will be treated in any Court or in any proceedings as a reasonable estimate of the creditor's loss. The relevant formula for this hearing is set out in Regulation 9, as already stated. (See Appendix A.)

[31] Sections 49 to 54 specifically deal with prepayments, though also relevant is s.43 entitled Prepayment Fees. Section 43 states:

> **43 Prepayment fees**
>
> (1) A fee or charge payable on a part prepayment under a consumer credit contract is unreasonable if, and only if, it exceeds a reasonable estimate of the creditor's loss arising from the part prepayment, including the creditor's average reasonable administration costs arising from part prepayments under consumer credit contracts of the appropriate class.
>
> (2) A fee or charge payable on a full prepayment of a consumer credit contract (other than a fee relating to administrative costs) is unreasonable if, and only if, it exceeds a reasonable estimate of the creditor's loss arising from the full prepayment as calculated in accordance with section 54.

[32] Section 49 deals with part prepayments. Section 50 provides for a debtor's right to full prepayment which must be accepted by a creditor at any time, and must be credited in accordance with s.46. Section 51 stipulates the amount required for full prepayment:

> **51 Amount required for full prepayment**
>
> (1) The amount required for the full prepayment of the consumer credit contract must be no more than the sum of the following less the amount referred to in section 52:
>
> (a) the unpaid balance at the time of the full prepayment; and
>
> (b) if expressly authorised by the contract, the administrative costs incurred by the creditor arising from the full prepayment or a charge equal to the creditor's average administrative costs arising from full prepayments of consumer credit contracts of the appropriate class; and
>
> (c) if expressly authorised by the contract, a fee or charge that does not exceed a reasonable estimate of the creditor's loss arising from the full prepayment.
>
> (2) In calculating the unpaid balance, the creditor must only include interest charges and other fees and charges that have accrued or would ordinarily be payable under the consumer credit contract up to the time of the full prepayment.

[33] Sections 52 and 53 deal with rebate of insurance and the termination of the consumer credit insurance contract on full prepayment of the contract. Section 54 sets out how a creditor's loss arising from full prepayment is to be calculated:

> **54 Creditor's loss arising from full prepayment**
>
> (1) A creditor must calculate a reasonable estimate of its loss arising from a full prepayment using—
>
> (a) a procedure prescribed for the purposes of this section by regulations; or
>
> (b) an appropriate procedure set out in the consumer credit contract for calculating that loss.
>
> (2) If a creditor uses a procedure prescribed for the purposes of this section by regulations, the amount calculated is to be treated in any court and in any proceedings under this Act as a reasonable estimate of the creditor's loss.

[34] The fundamental principle of statutory interpretation is that the meaning of an enactment must be ascertained from its text and in the light of its purpose. The strict literal meaning of a text may need to be re-interpreted to fit with the obvious purpose of the enactment. A principle purpose of the CCCFA is consumer protection. That is achieved through a framework of provisions requiring disclosure of adequate information to consumers under credit contracts (amongst other credit and finance documents), to provide rules about interest charges, fees and payments in relation to consumer credit contracts, and to prevent oppressive credit contracts and oppressive conduct by creditors under credit contracts.

[35] Since the principal issue in this case concerns interpretation of 'reasonable', it is useful to look at the use of 'reasonable' throughout the statute.

[36] Within the CCCFA, the word 'reasonable' appears many times, within two main contexts. Firstly, the word is used to import some sense of objectivity or objective standard into the provision, and secondly, 'reasonable' is used to constrain within the purposes of the Act the application of individual provisions.

[37] Provisions that use 'reasonable' to import objective standards to their application are as follows:

- Section 5, the interpretation section, states that 'full costs' includes reasonable costs incurred between solicitor and client, fees, and other expenses. An objective standard is created, whereby each case may be compared with costs incurred for similar cases, with an allowance made for competitive differences between solicitors.

- Section 16(d)(ii) allows for "a reasonable estimate … of the fair market value of the goods…." In this context, 'reasonable' has the effect of allowing for fluctuations and local differences in market value, while providing a sense of objectivity to the estimate.

- Section 24(3)(b), in relation to a request for disclosure, mentions "the date on which the creditor receives payment of a reasonable fee for the disclosure as specified by the creditor." The objective standard imposed by the word 'reasonable' in this provision is clear – its purpose is to allow precision in the determination of a starting date for a term of compliance, by not allowing the payer of that fee to pedantically dispute the fee specified in order to delay payment.

- Sections 32(1)(c) & (d) refer to a 'reasonable person', in relation to the standard of disclosure required. The authorities on such a 'reasonable person' are well known, and ultimately have the effect of providing an objective assessment standard within the context of that person's circumstances.

- Section 46(2) provides a specific definition of 'as soon as practicable' that applies only within that section. This is based on a reasonable creditor operating under the normal business conditions applying to that creditor. 'Reasonable' applies in its classic objective manner, applied to the specifically individual circumstances of each case.

- The changes that can be made to a consumer credit contract must be fair and reasonable to both the debtor and the creditor in all the circumstances, pursuant to s.56(2)(b). 'Reasonable' is clearly used in its objective sense,

being connected with 'fair', although it is placed within the context of the unforeseen hardship of s.55.]

- Under s 58(2), the Court may change the contract after allowing all parties a reasonable opportunity to be heard. In this sense, 'reasonable' holds its objective meaning, implying normal courtroom rules and procedure.

- A 'reasonable fee' is mentioned in s.67(3)(b), where payment of such sets the starting date for the lessor to comply with a request for disclosure within 15 working days. This same allowance is made in s.79(3)(b) for a request for disclosure for buy-back transactions.

[38] There are then the provisions that use 'reasonable' as a limitation on extremes of interpretation and application:

- The first occurrence of "reasonable" in the CCCFA is in s.3(d), which provides that a purpose of the CCCFA is to enable consumers to seek reasonable changes to consumer credit contracts on the grounds of unforeseen hardship.

- Section 21 (1)(b)(i) provides that continuing disclosure is not required if the creditor maintains a website that allows the debtor to access appropriate information. This website must be maintained at 'all reasonable times'. In this section, 'reasonable' requires some other factual information in order to obtain any meaning. It could safely be assumed that 'reasonable times' refers to the realistic ability of the creditor to update the information in a timely manner, thereby making it available to the debtor.

- In the context of cancellation of a contract, s.30(1)(e)(i) provides that the debtor is liable to pay to the creditor "any reasonable expenses necessarily incurred by the creditor...." Here 'reasonable' acts as a limitation on the claimable expenses, assisted by the precision of the rest of the provision.

[39] Because 'reasonable' only has meaning in relation to what is unreasonable, s.41 is important. This section provides that a consumer contract must not provide for a credit fee or a default fee that is unreasonable. It is for the Court to decide this unreasonableness, a finding that allows the Court to order the fee to be annulled or reduced. This is a core section in considering the concept of reasonableness because it expressly provides for its determination by the Courts.

[40] The important general point of note regarding s.41 is its purpose (provided by the interpretative guides found in s.42) to prevent the charging of fees that do not accurately reflect the costs incurred in relation to the matter to which the fee relates. In this sense, 'reasonable' acts in its limiting role.

[41] Sections 43 and 44 provide guidance on the reasonableness of fees payable on a prepayment under a consumer credit contract, or of credit or default fees. The fee is unreasonable only if it exceeds a reasonable estimate of the creditor's loss resulting from the prepayment. In this section therefore, 'reasonable' acts both as an objective standard (the object of the section) and as a limiting factor in that objective standard's determination. As a limiting factor, 'reasonable' looks to some objective frame of reference, such as commonly accepted estimates of losses and costs within the particular industry.

[42] Section 69(2) sets out the criteria of an unreasonable requirement as to the terms on which the debtor or lessee is to obtain credit-related insurance, a repayment waiver, or an extended warranty. Unreasonableness is defined by reasonableness, wherein the requirement must be reasonably necessary to protect the legitimate interests of the creditor or lessor, or reasonably justifiable in light of the risks undertaken by the parties.

[43] Section 80(1) provides that a buy-back transaction must not provide for a buy-back default fee that is unreasonable. There is no guide for determining an unreasonable fee. Sections 41-44 can serve as suggestive guidelines for s.80.

[44] Section 45(5) refers to a 'reasonable commission' that a creditor may charge in connection with any credit-related insurance taken out by the debtor. This

provision is an express acknowledgement that commissions are not illegitimate charges, so long as they are not excessive. 'Reasonable', therefore, acts in its limiting capacity in this section.

[45] Section 81(5) is an equivalent provision to s.45(5), although related to buy-back transactions.

[46] Section 51(1)(c) refers to the same 'reasonable estimate of the creditor's loss arising from the full prepayment' referred to in s.43, and calculated using the criteria within s.54. 'Reasonable' again occurs in its limiting capacity. As already noted, this calculation must be carried out under s.51(1) using one of two methods – either by a procedure prescribed by Regulations (set out in Regulations 9 & 11 of the CCCF Regulations 2004), or as set out in the consumer credit contract. Under this section therefore, 'reasonable' is tightly and expressly defined.

[47] Section 55 provides grounds for a debtor to ask the creditor that the terms of the credit contract be changed. These grounds are limited to reasonable and unforeseen causes for the debtor being unable to meet his or her obligations under the contract. This application cannot be made if it was reasonably foreseeable to the debtor at the time the contract was made that these causes would be likely to prevent his or her obligations from being fulfilled (s.57(i)(c). The non-exhaustive list of illness, injury, loss of employment or the end of a relationship provides general but well-defined guidance on the application of reasonable cause. The end of a relationship is then further defined in s.55(2), which suggests that the above list is more prescriptive than merely indicative, possessing a defined nature which is reflected in, and assists in the interpretation of, the word 'reasonable'.

[48] Section 68(a) provides that a reasonable estimate of the lessor's loss, is the limit to the amount payable by a lessee on the termination of a consumer lease before the end of its term. Again, there is reference to a procedure prescribed under Regulations.

[49] Section 106 provides for a defence of 'reasonable mistake' to a claim for statutory damages in connection with a breach of the CCCFA. 'Reasonable' is here

used in its limiting sense, preventing the possibility of the defence being invoked for negligent or otherwise preventable mistakes, or expressly for mistakes of law or interpretation of documents (s.106(2)). The onus of proof is on the defendant to show that the mistake that led to the breach was reasonable.

[50] Given the purpose of the legislation and the foregoing analysis of the use of 'reasonable' in many provisions of the statute, in interpretation of a reasonable estimate of the creditor's loss the consumer protection nature of the legislation must be a primary consideration. However reasonable must also mean reasonable in the circumstances, and in this case the parties are agreed that the circumstances of general principles of contractual law are relevant, as well as the particular circumstances of this hearing.

GENERAL PRINCIPLES OF CONTRACTUAL LAW

[51] It is well established that when there is a breach of contract and a consequent assessment of damages the party suffering the loss must take reasonable steps to mitigate its loss. If steps are taken in mitigation which are reasonable in all the circumstances then that party may recover its loss.

[52] In appropriate circumstances, damages may be assessed on the basis of what it will cost the claimant to obtain performance or completion of performance of the contractual undertaking by a third party (Chitty on Contracts, 29th edn, para. 26-016). In some situations, damages are assessed as the difference between the market value of the defendant's performance in its defective or incomplete state, and the market value of the performance if it had been properly completed.

[53] The general rule as to timing of assessment of damages is at the date of breach – when the cause of action arose, although the Court has discretion to fix another date that may better achieve justice and be more appropriate in the circumstances. (***Stirling v Poulgrain*** [1980] 2 NZLR 402.)

THE EVIDENCE

[54] At this hearing the informant called four witnesses. The first was Nicholas McBride, employed in the Ministry of Consumer Affairs in 1998 as policy advisor and later in the legal section of the Ministry of Economic Development as senior solicitor. He gave evidence about his involvement in policy work concerning the Bill which ultimately became the CCCF Act. His evidence traversed the preparation of drafting instructions for Parliamentary counsel, and also his instructions to Price Waterhouse Coopers who were charged with drafting the formula now enshrined in the Regulations and known as the safe harbour formula.

[55] Andrea Gluyas gave evidence as an actuary and a director with Price Waterhouse Coopers. She was qualified as an expert witness and was herself directly involved in drafting the safe harbour formula following instructions from the Ministry. Her evidence also traversed her opinion as to the Avanti formula and its perceived shortcomings, in her view.

[56] The informant also called Murray Lazelle, a forensic accountant and director who was presented as an expert witness. He discussed the structure of Avanti's business, the Avanti prepayment formula and, like Ms Gluyas, Mr Lazelle undertook a comparison with the safe harbour formula.

[57] The final witness for the informant was Janis Adair, senior investigator with the Commerce Commission who produced a number of exhibits, including extensive correspondence between the Commission and the defendant company, the company's response to a number of requests for information from the Commission, and other documents obtained in the course of the investigation. Most of these were not directly referred to in the evidence, but I have had the benefit of perusing all of the exhibits produced following the hearing.

[58] The defendant company chose to call evidence at the hearing and I heard from Glenn Hawkins, chartered accountant and director of the defendant company as to the way in which Avanti operates, its business structures, and how the Avanti

prepayment formula was developed after an analysis of its business and after taking legal advice.

[59] The defendant company also called Professor Robert Bowman to give expert evidence on the significance of excess capacity, to comment on the safe harbour formula and to address the issues in this hearing concerning a reasonable estimate of loss.

[60] The defendant company produced a number of exhibits, including background documents concerning the drafting of the legislation, information concerning the defendant's company and its funding, and a number of letters and other documents analysing the 50 loans subject of the charges, full loan details for five of those loans, and other material of relevance to the Court's determination. Again, many of the exhibits were not directly referred to in the evidence, but I have had the opportunity of reviewing all of those exhibits following the hearing.

[61] The CCCF Act gives debtors the right to repay early. In the words of Ms Gluyas:

> There must be a penalty to breaking a fixed rate contract if that is now to the benefit of the debtor and the detriment of the creditor, otherwise the product or industry could become unsustainable. The repayment formula is therefore designed to protect creditors where there is an incentive and advantage to the debtor of refinancing. (At paragraph 15 of her brief.)

[62] The safe harbour repayment formula to which that witness referred, and in which she was involved in drafting, contained in Regulation 9 and referred to in s.54 is designed to "protect a creditor which has itself entered into a fixed rate contract to offset the loan being repaid" (at paragraph 16 Gluyas brief.) As she further explained, the formula did not envisage any loss if interest rates were higher than when the prepaid contract was agreed, although there was provision for an administration charge to be made. If interest rates have fallen however, the safe harbour formula specifies a fee to be payable by the debtor, and "that fee is calculated as the present value of the difference between the stream of payments the creditor was expecting under the original contract and that which the creditor will be

able to obtain by relending the repaid funds at prevailing interest rates. This returns the creditor to its original position". (Gluyas at paragraph 18 brief.)

[63] Clearly the safe harbour formula only addresses loss of interest if the interest rate changes. It is an actuarial calculation based on the twin principles that discount for present value must be allowed for and the creditor has an ability to relend the repaid funds.

[64] Ms Gluyas accepted that there may be other losses to a creditor not allowed for in the safe harbour formula. If the safe harbour formula had been applied to the 50 credit contracts subject of this hearing, Ms Gluyas' conclusion was that no compensation payments would have been made by Avanti's debtors. Unsurprisingly, Ms Gluyas' findings on consideration of the Avanti formula were that there was no allowance for mitigation of lost profit through relending other than by limiting the period of length of interest to 90 days, and no allowance for the fact that the outstanding balance would otherwise be reducing over the 90 day period.

[65] Importantly, the Avanti formula in her view made no allowance for the time value of money (i.e. does not use present value). Additionally, although the introduction to the formula referred to a creditor's loss arising if the creditor's current interest rate is lower than the interest rate applying to the original consumer credit contract, the formula did not address that at all, and the formula was applied irrespective of changes in Avanti's interest rates. Finally in her view the formula effectively requires a penalty for early prepayment of (up to) 90 days worth of interest at the current daily rate without linking that to Avanti's reasonable loss.

[66] Mr Hawkins, a director of Avanti, stated that the safe harbour formula did not reflect Avanti's business because subsequent lending would occur regardless of any prepayment. He said:

> In our view, the loss that Avanti suffered on prepayment was the loss of future net income from that loan and any costs in early termination. We therefore developed a formula that produced a reasonable estimate of that loss of margin. To ensure that the estimate was conservative, we capped the period of the lost margin at 90 days, even though we had advice that we could charge for the remainder of the loan. (Brief paragraph 2.)

> Avanti's loss when a customer prepays a loan early is therefore the unearned interest on the loan less the amount saved by repaying the bank facility for the duration that the contract still had to run. (Brief paragraph 49.)

[67] Mr Hawkins' evidence was that the prepayment fee calculated under the Avanti formula is actually less than a reasonable estimate of Avanti's loss. In the credit market Mr Hawkins stated that Avanti had been careful in who it lent to and on what terms, and as a result of maintaining its relatively strict lending criteria had in fact lost a number of customers to competition as a result. However, the quality of Avanti's loan book and arrears remained steady, and according to his evidence individual write-offs were small amounts and had remained under control, and therefore Avanti had been able to keep a good quality loan book in times where other finance companies had experienced severe difficulties.

[68] Mr Hawkins stated:

> Even after fourteen years in the business, it is difficult to accurately predict early prepayments from week to week or month to month, as they are affected by factors outside of our control. It is important to have a bank facility that accommodates these daily and monthly fluctuations and provides the facility to repay debentures or meet other unexpected conditions when they occur. (Paragraph 35 Hawkins' brief.)

[69] Mr Hawkins explained that Avanti had maintained a significant unused bank facility during the period of the charges, because the facility had been increased in 2004 to enable planned growth in the loan book. The plan was to actively grow the book of interest only loans, to grow the principal and interest loans, and for dealer loans to be stabilised. As things turned out the P and I book did not grow initially, but that started to grow again over the period, and the interest only book did increase.

[70] Mr Hawkins' evidence was that in the period from March 2005 to March 2007 the overall interest rates at which Avanti was able to lend had been reducing (Schedules 3-6 of his brief). Those interest rate reductions were partially due to a change in Avanti's lending mix but mainly due to changes in the market. He also said that over the same period the 90 day bank bill rate had been rising (Exhibit 42).

[71] Murray Lazelle, an experienced forensic accountant, gave expert evidence at this hearing. His opinion was that the Avanti formula had no regard to changes in interest rates, and the loss calculation approach did not represent a reasonable estimate of its loss and in fact resulted in an excessive recovery.

[72] He explained this conclusion by referring to how, in his view, the Avanti formula calculated a loss by reference to Galatos' costs of funds. He stated that Avanti's own source of funds was primarily debentures, and the cost of funds on debentures had varied, but Galatos' costs of funds on its bank facility was lower than Avanti's. He concluded therefore that in effect Galatos would have a higher margin than Avanti as Galatos' cost of funds was lower. In his opinion the Avanti formula sought to recover lost margin, but the lost margin recovered was a margin based on Galatos' position not Avanti's. The fact therefore, in Mr Lazelle's view, was that Avanti recovered a higher margin than it derived in reality.

[73] Mr Lazelle was of the view that Avanti's claimed inability to predict prepayment by its lenders was exaggerated, and the company could mitigate its loss other than by repaying the National Bank facility. The appropriate mitigation would be to make a new loan, and Mr Lazelle referred to Exhibit 41 which set out the movements on the ANZ National Bank facility over the period of the charges. In his opinion there was no clear correlation between loan prepayments and any sums repaid to the bank facility over that period.

[74] Mr Lazelle stated that any claim by Avanti that it could only mitigate its loss by repaying its short term bank facility would be inappropriate because it was inappropriate in principle that a creditor's loss be determined by such options. He stated that Avanti has chosen to finance the business by way of high cost funds i.e. debentures, and those decisions made by shareholders and directors should not be recovered from borrowers who have no control over the decision making.

[75] It was this witness' opinion that it was inappropriate that the effect of the Avanti formula was that it recovered a loss equivalent to 90 days lost margin, a time based calculation, particularly because decisions about the running of the company and whether the loan book was growing or in decline were not factors that should be

used as a justification for a creditor's loss calculation. He referred to a table he had compiled to set out variations in the value of prepayments and the value of new loans in a period from April to November 2006 as an example of the significant variation in new loan activity, and fluctuation in prepayment over that time.

[76] Mr Lazelle commented on the safe harbour formula and confirmed that it was derived from commonly applied present value discounting techniques and essentially calculated the difference between two streams of cash flows. Firstly, the series of cash flows negotiated with a borrower, and secondly, the lender being assumed to have mitigated its loss making a new loan potentially at a different interest rate, and the first series of cash flows therefore being replaced with another series of cash flows. He stated:

> The intention of the calculation is to put the creditor back in the position it otherwise would have been but for the prepayment. In effect, the lender will be able to take the sum prepaid together with its loss (if any) and reinvest it at the new rate. The safe harbour formula gives the creditor the same earnings from the transaction that it would have originally had. (Paragraph 46 brief.)

[77] Mr Lazelle's view on examination of documents supplied to the Commerce Commission by Avanti was that there was no evidence of any decline in operative lending rates between April 2005 and March 2007.

[78] Professor Robert Bowman was called by Avanti to give expert opinion evidence. Professor Bowman holds the Chair in Finance at the University of Auckland, Business and Economics Faculty. As well as his current academic post and past academic positions, Dr Bowman was a manager with an international accounting firm and has held many engagements as consultant for companies in this country and overseas.

[79] Professor Bowman's opinion was that the safe harbour formula was not appropriate as a formula to provide a reasonable estimate of a creditor's loss for many circumstances in the finance industry, and specifically not appropriate for the defendant company. He reviewed in his evidence the Avanti formula, agreeing with Ms Gluyas that its two principal defects were the lack of any present value calculation and the lack of any allowance for a declining balance over the 90 day

period. However, his opinion was that those defects were overcome in most cases under consideration because of the limitation of calculated losses to those within 90 days.

[80] Professor Bowman went on in his evidence to create a formula himself which in his view more precisely calculated Avanti's loss, and then to compare his formula with Avanti's formula on particular examples drawn from the evidence.

[81] This witness' opinion was that the most important aspect of the case was the significance of excess capacity when calculating loss on prepayment and the appropriate application of the concept of loss mitigation in those circumstances. He stated:

> If a loan is prepaid in circumstances where the finance company has excess lending capacity and then a new loan is written, the finance company is not relending. It is simply writing a new loan. The fundamental point is that, in circumstances where a finance company has excess to funds to lend, a prepayment does not **create** any lending opportunities. (Brief paragraph 4.9.)

[82] Professor Bowman gave as illustration of the concept of relending not being applicable to loan prepayments in the case of the defendant company examples of advance booking at a hotel or of a flight with an airline. Although he readily acknowledged that the circumstances of those types of business were different to a finance company, the analogies were made to show in simple terms what loss might be suffered by a hotel or an airline if their facilities are not fully booked and there are excess rooms or seats to sell, and one of the existing bookings cancels. His point was that in that situation the hotel or airline still loses the revenue from the cancelled booking, and his opinion was that whether or not there is excess capacity therefore is a critical issue in determining a loss calculation in those examples, as it is with the prepayment of a loan.

[83] As a financial economist Professor Bowman suggested that the safe harbour formula essentially espoused three principles which he agreed were appropriate:

- There is potential for loss when a loan is prepaid.

- The loss is calculated by the difference between the present value of the interest that was to be earned under the prepaid contract and the present value of the appropriate action by way of mitigation.

- The loss can be claimed for the entire duration of the contract yet to run.

[84] However, in his opinion the way the safe harbour formula applied those propositions was inappropriate because there was an implicit assumption in the safe harbour formula that the finance company had no excess capacity and a link was assumed between a prepayment and a new loan. Because of this, in Professor Bowman's view the safe harbour formula is seriously flawed and inappropriate in most prepayment circumstances.

[85] He went on in his evidence to examine Avanti's formula which does not consider relending or changes in the lending rates, and focused on the difference between the interest rate in the original contract and the interest rate paid on the funds that it lends. In his view that was the correct focus because it was based upon the fundamental value creation function of a finance company. He stated:

> A finance company earns its profits by borrowing money at an interest rate and then loaning the money to its customers at a higher rate. A finance company mitigates its loss of profits that arises from an early settlement by reducing its borrowings. (Brief paragraph 6.3.)

[86] Professor Bowman developed his own formula which in his view more precisely measured a creditor's loss on prepayment of a loan and then compared his formula to the Avanti formula calculation. His conclusion was set out thus:

> The analysis I undertook shows that the average prepayment fee charged by Avanti on a loan prepaid a year in advance will be less than half of its loss. Since the average prepayment is more than two years in advance, Avanti's average prepayment fee will have been significantly below what I calculated to be a reasonable estimate of its loss. (Paragraph 7.21 brief.)

[87] His overall conclusion was that, when a comparison was made between his formula and Avanti's formula for the 50 prepaid loans subject of the charges, only one loan was charged at prepayment fee by Avanti that was greater than the fee calculated under the formula that he had himself developed, and the amount

concerned on that loan (number 102628) was $8.27. Professor Bowman's conclusion was that 98% of the loans concerned in this case were actually undercharged, and on average Avanti's formula actually resulted in its customers receiving substantial benefit, as compared to his more precise formula. His conclusion therefore was that the Avanti formula was a reasonable estimate of its loss.

[88] Professor Bowman was critical of Ms Gluyas and Mr Lazelle because their evidence as to reasonable loss on prepayment was determined by reference to the safe harbour formula which was based upon relending and they had both assumed that loss mitigation was only to be achieved by a relending process. On that basis, in his opinion their evidence was fatally flawed because it lacked an understanding of the way in which Avanti conducted its business with the substantial excess lending capacity available from the bank facility. In his opinion, the link to time to relend was neither sensible nor reasonable. His further opinion was that there was no economic reason why a finance company should have to limit a prepayment fee. He accepted that he had not studied the CCCF Act or the background to its enactment.

INFORMANT'S CASE

[89] The Commerce Commission alleges that the formula used by the defendant company results in an unreasonable estimate of its loss because:

a) The 90 day period in the defendant's formula does not take into account that over that 90 day period the balance of the loan will be reducing and therefore the amount of interest payable will be similarly reducing.

b) The Avanti formula does not calculate loss based on the present value of future payments.

c) The Avanti formula imposes an arbitrary 90 day interest period which does not relate to its time to relend funds.

d) There is no justification for Avanti's claim that it is entitled to the unearned interest margin on loans prepaid.

e) The Avanti formula has no regard to whether prevailing interest rates have risen or fallen, and therefore has no regard to a variation in rate at which it could lend its funds.

f) The Avanti formula does not take into account that the company can and did mitigate its losses by relending the funds prepaid.

[90] The informant rejects the company's position that it cannot relend because it has "excess capacity". The informant submits that in this regard Avanti is no different from any other prudent creditor and is not a special case.

[91] The Commerce Commission submits that the company's formula is a method of capturing three months of future profit in a situation where the company has use of the money repaid and is offering no service to the debtor who had repaid. In addition, the submission is made that the defendant company has no risk associated with the prepaid funds.

[92] The informant also submits that the Avanti formula does not reflect a debtor's right to repay and the consumer protection nature of the legislation.

[93] The Commerce Commission also alleges that the defendant company's credit contract misled debtors about the formula to be used in the event of prepayment because of the representation made in the prepayment section that the creditor may have suffered a loss if interest rates have fallen. The company's credit contract did not take that into account, and therefore the representation made was misleading.

DEFENDANT'S CASE

[94] The defendant company maintains that because it always has excess funds when a debtor chooses to make full prepayment Avanti's loss is the whole of the unearned interest to the end of the contract term. Ability to make a second loan is

only relevant if the second loan arises by virtue of early repayment of the first loan. In the circumstances of this company's trading the second loan is not relevant to Avanti's loss on prepayment.

[95] The most profitable use of funds received on prepayment is to reduce the amount borrowed by Avanti. It therefore treats the debtor as if the bank facility had been reduced by the amount prepaid. The difference between the amount that would be saved from reducing, or not drawing on the facility, and the interest rate on the loan over the remainder of the loan period is the loss suffered.

[96] Avanti developed a formula to calculate its loss that in fact understated its estimated loss. The loss of future interest less cost is loss of profit, and a claim that prepayment ends a service and so no loss is suffered is fundamentally inconsistent with long established common law rules, it is submitted.

[97] The circumstances of the defendant company, the creditor, must be the relevant circumstances when assessing the company's loss arising out of prepayment. The safe harbour formula only captures one concept of loss and is not appropriate to the Avanti business structure. It is entirely appropriate for Avanti to have excess lending capacity and to estimate its loss based on the usual common law principles.

[98] The loss on prepayment the company considers to be the lost profit on the loan and its additional administrative expenses in closing the loan early. The formula under which it calculates its fee does not include an administrative charge, but the loss for not charging that fee is a loss that is taken into account in a general sense.

[99] It is submitted in essence, that because Avanti prudently always has excess funds, its loss on full prepayment is always the outstanding amount, and it chooses to cap this at 90 days to align with its own bank arrangements. In many cases this does not actually reflect its loss but the company judges it a fair and reasonable estimate of its loss.

ISSUE 1 – IS AVANTI'S FULL PREPAYMENT FORMULA A REASONABLE ESTIMATE OF ITS LOSS?

[100] The Commerce Commission must establish beyond reasonable doubt that Avanti either required an amount for the full prepayment of each of the 50 consumer credit contracts that exceeded the sum provided for under the Act (s.51), or that it calculated an unreasonable estimate of its loss arising from full prepayment of each of the 50 consumer credit contracts (s.54). Both sections and the informations as charged essentially require an assessment of whether the Avanti full prepayment formula is a reasonable estimate of its loss.

[101] There is no dispute in this case that the 50 contracts subject of the charges are consumer credit contracts and therefore are required to comply with the provisions of the CCCF Act. Further, there is no dispute that Avanti Finance Ltd is a creditor for the purpose of the Act and that each of the persons named in the informations was a debtor as defined in the legislation and that each had made full prepayment in terms of the particular contract. The statutory defences of reasonable mistake set out in ss.106 and 107 do not apply.

[102] Essentially, s.51 requires that the total amount a debtor must pay for full prepayment is no more than:

- The unpaid balance at the time of the full prepayment, *plus*
- The creditor's administrative costs arising from full prepayment *plus*
- A reasonable estimate of the creditor's loss arising from full prepayment *less*
- A proportionate rebate of any consumer credit insurance contract.

[103] The CCCF Act establishes a legislative framework which, in the context of this case, provides that there is:

- An unconditional right for any debtor to chose to make full prepayment of a credit contract at any time.

- A right for a creditor to be compensated for loss occasioned by a debtor's choice to make full prepayment of a credit contract.

- No obligation for a creditor to use the safe harbour formula set out in the Regulations under the Act.

- A requirement that loss claimed by a creditor from a debtor on full prepayment of a credit contract must be a reasonable estimate of the creditor's loss.

[104] The central issue in this case is the determination and quantification of loss. Loss under a credit contract must be the gain the creditor would have made if the contract had run its course and not been prepaid. The principles of general contractual law and mitigation on breach of contract apply. The context of the legislative purpose of the CCCF Act is central.

[105] Every prudent finance company would clearly have some excess capacity, some leeway in its business so that if there is default or prepayment it can survive. The undisputed evidence at this hearing was that the defendant company had a particular company structure which meant that there was a very large unused bank facility at the time of prepayment of the 50 credit contracts subject of the charges. I accept as a matter of fact that prepayment decisions made by existing debtors during the period of the charges did not result in the defendant company being able to thereby create new lending opportunities or grant new loans. Prepayment merely resulted in those prepayment funds coming into the company's accounts. Avanti always had excess capacity to lend during this period.

[106] Accordingly, there was, I accept no link between prepayment and subsequent lending under any new loan. As has been abundantly explained during this hearing, the safe harbour formula was developed on the twin principles that payment for future loss must be discounted to present value and a loss should be mitigated. Whilst those are entirely appropriate and logical principles in this area of credit finance, the resulting formula only applies to one type of estimated loss, that is loss of interest on future loans. If a prevailing interest rate is the same as or higher than

the interest rate that a debtor who prepays is being charged, then the creditor's loss would be zero because the creditor can either make the same amount, or more than it would have earned under the original debtor's contract by advancing the money to another debtor. If the prevailing interest rate is less than the interest rate the debtor is being charged, some loss will have been suffered. In particular the loss will be the value of the foregone payments less the amount of the unpaid balance.

[107] The evidence of Antonia Gluyas and Murray Lazelle in explanation of the safe harbour formula and in criticism of the Avanti formula is based entirely upon this concept of loss. Underpinning the evidence of both of those witnesses was the concept that for a finance company in the business of making money through lending the primary loss mitigation is relending.

[108] I accept Mr Hawkin's evidence that the safe harbour formula is simply not appropriate to the Avanti company structure and way of doing business over the period which these charges are concerned with. The company did not relend immediately. I found Mr Hawkins to be an honest witness. I accept his evidence that Avanti made every effort to interpret the new statute and took legal advice to try to ensure that its contracts complied with the law and also that the prepayment formula it developed was appropriate.

[109] Mr Hawkins has given evidence to the effect that in fact over the period the case is concerned with interest rates had risen and lending rates had fallen. This evidence is at odds with the conclusions of Mr Lazelle, but there is no dispute that Avanti had a large amount of undrawn on reserve at the bank. In my view, that is the important aspect of the evidence rather than an analysis of interest rates and numbers of new loans during this period.

[110] 48 of the 50 credit contracts subject of these charges were prepaid more than 90 days before the contract end date. Only two were inside that 90 day period taken by Avanti in its prepayment formula (contracts 102628 – information numbers CRN ending 2096 and 2047) and contract number 104371 (information numbers CRN ending 2114 and 2062). The Avanti formula makes no allowance for any

administrative fee, though Mr Hawkins' evidence was that there would be an expense of at least $40 for each contract in closing it on prepayment.

[111] Having accepted that the loss on each credit contract would be the outstanding payments, is it reasonable for Avanti in its prepayment formula to cap that loss at 90 days, and further not to present value the payment nor to factor in a reducing balance?

[112] The evidence has been that the decision to set the prepayment fee at 90 days (and adjusted for contracts with less than 90 days to run) was made on the basis that this allowed the company to treat the debtor as if the bank facility the company had had been reduced by the amount prepaid. The difference between the amount that would be saved in effect from not drawing on the bank facility and the interest on the loan over the remainder of the outstanding term was the loss suffered. The 90 day "cap" was seen as reasonable in that context.

[113] Professor Bowman's evidence as to whether the Avanti prepayment formula is reasonable is of particular importance. That witness stressed and I have accepted there was no link in Avanti's business between full prepayment being made and any subsequent lending. Further, it is not relevant that interest rates may have fallen or indeed risen. The focus is on the company structure and there is nothing in the legislation to say that Avanti cannot run its company and source its funds as it wishes. The legislation does stipulate proper disclosure must be made, that credit contracts must not be oppressive, and uses the word 'reasonable' in many sections of the law, as already discussed.

[114] Consumer protection as a principal purpose of the legislation sets out the need for full disclosure and a reasonable estimate of loss. Professor Bowman's financial analysis of both the safe harbour formula and Avanti's formula, and his own creation of a suggested appropriate formula I have found of particular interest. The two principal drawbacks of the Avanti formula, as discussed by both Professor Bowman and Ms Gluyas, are that it does not present value payments and no allowance is made for a reducing balance. However, Professor Bowman's calculations demonstrate that even if those two factors had been present in the

Avanti formula the impact on all but one of the 50 contracts would have been of no practical effect, and the contract in which there would have been an effect (contract number 102628) was overpaid by a small sum. The importance of Professor Bowman's evidence was, in my judgment, in demonstrating that where excess capacity exists and a company chooses to structure itself in the way that Avanti has, a reasonable estimate of loss on prepayment must be seen in the context of no lending opportunities being created, therefore no mitigation by relending and the only reasonable option for mitigation being to repay the bank facility.

[115] Therefore, the effect of the Avanti formula is, I accept, that the debtor obtains what can be seen as a benefit of the prepayment being treated as if it was immediately paid to the bank to offset the interest charged since Avanti treats the debtor as making a prepayment on the basis that funds are immediately invested at the 90 day bank bill rate plus 1.9%. The 90 day cap means that the Avanti formula calculates a fee less than the company's loss if the prepayment occurs when a contract has 20 weeks to run, which is the case in all but two of the 50 contracts under consideration.

[116] Looking at Professor Bowman's own formula, which in his view precisely estimated Avanti's loss, given the findings I have made and the context of the company structure, I am satisfied that the Avanti formula did in fact reasonably estimate the company's loss. In the one case (informations ending 2096 and 2047) where the Avanti formula resulted in a small overpayment, I am satisfied that this is still a reasonable estimate of the company's loss in that case. A perfect estimate could present value payments and take account of a reducing balance over the 90 days. The legislation requires a reasonable estimate. I note that no administration fee was charged to any debtor, a fee which could well have been at least $40 and could have been claimed in each case.

[117] I conclude therefore that the informant has not proved beyond reasonable doubt that, contrary to s.51 Avanti Finance Ltd required an amount for the full repayment of consumer credit contracts that exceeded the sum provided for under the Act, nor has the informant satisfied me beyond reasonable doubt under s.54 that Avanti Finance Ltd calculated an unreasonable estimate of its loss arising from a full

prepayment of the consumer credit contract in each case. Those informations are accordingly dismissed.

ISSUE 2 – IS THE WORDING OF ONE SENTENCE IN ITS FULL PREPAYMENT CLAUSE MISLEADING?

[118] The Commerce Commission must satisfy me beyond reasonable doubt that the defendant company made a false or misleading representation concerning the price of a service (s.23(g) Fair Trading Act 1986) or made a false or misleading representation concerning the existence of a condition (s.13(i)).

[119] There is no contest in this case that the defendant company is a person under the Act, that a representation was made, the defendant company was in trade, and the representation was made in connection with the supply of a service, the representation was made about the service with respect to the price. The final element that must be proved beyond reasonable doubt and is squarely in dispute is whether the representation was false or misleading. Section 44 of the Act which provides a statutory defence does not apply in this case.

[120] The representation subject of the charges is in the full prepayment clause of each of the 50 credit contracts and states:

> The creditor may have suffered a loss if the creditor's current interest rate is lower than the interest rate applying to your original consumer credit contract.

[121] It is common ground that the Avanti formula set out in the full prepayment clause does not take into account any change in interest rate. The representation occurs in the sentence which follows the first sentence in the full prepayment clause which states:

> If you pay the unpaid balance in full before the final payment is due (**full prepayment**), you may be required to pay a fee or charge to compensate the creditor for any loss resulting from the full repayment.

[122] It is followed by a sentence which states:

> You may also have to pay the creditor's administrative costs relating to the full prepayment.

[123] Is the sentence complained of misleading when read in the context of the overall statement and followed by the formula itself which states clearly in the preamble:

> The amount you may have to compensate the creditor for the loss is calculated using the following formula.

[124] There is no evidence of anyone being misled by the sentence complained of although, of course, that is not a requirement of the offences alleged. I note also that an actual intention to mislead is not necessary. No mental element is required, these being strict liability offences.

[125] Whether a representation is false or misleading is determined by what was represented by the words used in their context. This is generally assessed by reference to the class of persons to whom the representation is directed. The assessment is to be made objectively. Neither the intent of the representor nor the effect of the representation is determinative (***Commerce Commission v Whitehead***, High Court, Wellington, CIV-2006-485-000088, 4 July 2007).

[126] As was clear from the evidence of Mr Hawkins, Avanti's average interest rates did fall during this period, but the more important assessment of these charges is whether in the context the sentence is placed in the full prepayment clause it is false or misleading.

[127] In prosecutions of this nature under the Fair Trading Act the nature of the target audience is relevant to any issue of representation (***Commerce Commission v The Zenith Corporation Ltd*** [2006] DCR 757). The target audience for credit contracts is obviously debtors. The full prepayment clause contains a formula which, I can readily accept, contains actuarial calculations which the ordinary debtor may not immediately understand. However, it is important to read the representation which is alleged to be a misrepresentation in context. The clause starts by saying that "if you pay the unpaid balance in full before the final payment is due (full prepayment) you <u>may</u> (emphasis added) be required to pay a fee or charge to

compensate the creditor for any loss resulting from the full prepayment". The clause then goes on to say that the creditor may (emphasis added) have suffered a loss if the creditor's current interest rate is lower than the interest rate applying to the original consumer credit contract and then goes on to say that the debtor may (emphasis added) also have to pay a creditor's administrative cost relating to full prepayment.

[128] Counsel for the informant has submitted that the representation objected to implies that the safe harbour formula will be used because that formula includes an adjustment for a loss in interest rate, when in fact that formula is not in fact used by the defendant company. However, there is no basis in the full prepayment clause for an ordinary debtor to make that assumption. All that the representation objected to states is that the creditor may have suffered a loss if interest rates have dropped. Indeed if interest rates have dropped of course the creditor would have suffered a loss irrespective of whether, as I have decided in this case, that creditor had excess capacity or not. Again, as noted, the following statement that a creditor's administrative costs may have to be paid by a debtor, though not alleged to be a misleading representation, is also a statement of a possibility. Of course, administrative costs are not included in the Avanti formula.

[129] Reading the representation objected to within the contract clause as a whole I am not satisfied that the informant has proved beyond reasonable doubt that the representation made was either false or misleading in terms of s.13(g). Those charges are dismissed. In terms of the charges laid under s.13(i) of the Fair Trading Act 1986, the alternative charges, I accept the submission of counsel for the defendant company that there is no representation at all concerning the existence of a condition. These charges are accordingly dismissed.

Dated at Auckland this day of June 2008 at a.m./p.m.

(AE Kiernan)
District Court Judge