MARK COLLINGE CARRUTHERS

CREDIT CONTRACTS ACT 1981: DIRECTIONS FOR REFORM

AN EXAMINATION OF SELECTED PROBLEM AREAS WITH PROPOSALS FOR REFORM

LLM RESEARCH PAPER
SALES AND SALES FINANCING
(LAWS 527)

LAW FACULTY
VICTORIA UNIVERSITY OF WELLINGTON

1993

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ABSTRACT

This paper examines the background to the enactment of the Credit Contracts Act 1981 and critically reviews the operation of that Act in the years to 1993 with a view to identifying and analysing three selected legal problem areas which have emerged. Where such legal problem areas are identified, reform proposals are formulated which are designed to clarify an area of uncertainty in the most appropriate way and in some cases, to recommend a rethink of policies which may no longer be appropriate to achieve the stated objectives of the Act.

The text of this paper (excluding contents page, footnotes, bibliography and annexures) comprises approximately 19,000 words.

High interest rates reward with income a very considerable and very influential part of the community of contentment. In the accepted economic attitudes, however, central-bank policy is socially neutral. In fact it strongly favours the rentier class, a group that is both affluent and vocal. It is an indubitably inescapable fact that those who have money to lend are likely to have more money than those who do not have money to lend - an economic truth that stands on a par with the unimpeachable observation attributed to Calvin Coolidge that when many people are out of work, unemployment results.

John Kenneth Galbraith
The Culture of Contentment
1992

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CREDIT CONTRACTS 1981

DIRECTIONS FOR REFORM

1. INTRODUCTION

This Research Paper provides a brief background to the enactment of the Credit Contracts Act 1981, with commentary, sets out the main features of the Act, again, with commentary, identifies three selected areas where problems with the Act have occurred, and formulates recommendations for amendment to the Act in those selected areas.

2. BACKGROUND TO THE ACT

In March 1968 the then Minister of Justice instructed the Contracts and Commercial Law Reform Committee to study the law relating to money lending transactions and other agreements involving the extension of credit and to recommend reform in this area of law. Just short of 9 years later, in February 1977, the Law Reform Committee's report on credit contracts was presented to the Minister of Justice.[1] Including appendices, the report runs to 212 pages. It is not an easy read. Neither is its progeny, the Credit Contracts Act 1981.

The major impetus for the reference by the Minister of Justice to the Contracts and Commercial Law Reform Committee in 1968 was a widespread recognition that the Money Lenders Act 1908 was no longer adequate to control and regulate the extension of credit and the regulation of credit transactions in a society which had moved on considerably in its commercial practices in the 60 years since the Money Lenders Act was passed.

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1 Contracts & Commercial Law Reform Committee, Report on Credit Contracts, Govt. Print, Wellington, 1977

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The Money Lenders Act was of a very narrow application. It only applied if the financier was a money lender and if the credit was extended as a loan. The Act didn't apply to loans made by anybody other than a money lender and it also didn't apply where the transaction was not structured as a loan. To be a money lender a person had to be in the business of money lending. Excluded from the definition of money lender was any person who bona fide carried on business in the course of which money was lent by that person at no more than 10% interest. All money lenders had to be registered under the Act. There were restrictions on how a money lender could advertise his or her business, the form of a money lending contract was prescribed, there was a requirement that a memorandum setting out the credit terms of the transaction should be signed by the borrower before the money was lent, and the Court was empowered to reopen any money lending transaction which it considered to be harsh and unconscionable. In reopening a money lending transaction the Court could determine a suitable rate of interest to apply to that contract in the future and also to take an account between the parties to determine, inter alia, any amounts that should be refunded to a borrower or credited towards future loan repayments.

So, technically there were three legal prerequisites before the Act applied: money had to be advanced by way of loan by a person who was in the business of money lending. Attempts to avoid one or more of these three preconditions lead to artificiality in the arrangement of certain types of credit transaction. Most commonly, a sale transaction was substituted for a loan. Another common device was to structure loan transactions as absolute assignments of book debts or the discounting of bills of exchange.

As a result of attempts to avoid the application of the Act by structuring transactions so that they would not be legally classified as loans, a great deal of uncertainty crept into the law. This was particularly the case since the law relating to sham transactions was still, at that stage, in a state of flux. Some decisions[2] pointed to an approach which looked no further than the intention of the parties as

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2 Snook v London and West Riding Investments Ltd [1967] 2 QB 786

expressed in the documents, while other case law[3] showed a willingness to go beyond the formalities of the documentation to look at the functional reality of the transaction, and classify a transaction in terms of its function and effect rather than its legally expressed form.

A further defect in the Act was its extremely narrow application. When the Money Lenders Act was in force there were only two ways to reopen a harsh and unconscionable money lending transaction. The first was the situation where there was a loan made by a money lender. In this case section 3 of the Money Lenders Act applied. If the transaction in question related to a hire purchase agreement then relief was available under section 37 of the Hire Purchase Act 1971. However any transactions which fell outside of these two legislative provisions were not subject to any legislative doctrine of unconscionability, so that a contract could be reopened. For example, if there was a discounting transaction or a credit sale which was unconscionable there was no protection available for the instalment buyer or the borrower.

Not only was the Money Lenders Act open to criticism on the basis that it had an extremely narrow focus, and that it could be avoided by careful structuring of transactions so that they were other than loan transactions, but the penalties for contravention of the Act were also extremely harsh. For example, if a person carried out a money lending business without registering as a money lender or carried on the business from a new address without first registering the change in the address of his or her business premises, then a loan made from the new office would have been illegal and completely unenforceable. (Remember, the Illegal Contracts 1970 did not come into force until 1 December 1970). In its 1977 Report,[4] the Contracts and Commercial Law Reform Committee considered it unreasonable to allow a borrower to make an undeserved windfall

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3 Cash Order Purchases Ltd v Brady [1952] NZLR 898, Premor Ltd v Shaw Bros [1964] 1WLR 978. But see also Bateman Television Ltd v Coleridge Finance Co. Ltd [1969] NZLR 794, at 813 when Turner J, in the New Zealand Court of Appeal, expressed a rigorous view of a sham whereby a transaction could only, properly, be viewed as a sham where "really doing one thing, the parties have resorted to a form which does not fit the facts, to deceive some third person ..... that they were doing something else."

4 Supra n.1. pp 36-38, paras 3.14 and 3.15

profit, solely because a lender had committed a technical breach of the Act which could not be shown to have harmed the borrower in any way.

In summary, the disadvantages of the Act were that financiers were tempted to avoid the operation of the Act by dressing up loan transactions as something else, a practice which resulted in artificiality and uncertainty; transactions originally intended as non loan transactions were open to question because sometimes they were challenged on the ground that in reality they were loan transactions; the reopening provisions of the Act applied only to loans by money lenders and to loans at an interest rate exceeding 10% by non money lenders, and the effect on the lender of contraventions, even of a purely technical nature, were excessively harsh, with no provision to ameliorate these penalties in certain circumstances.

After extensive research and consultations and references to consumer credit reports prepared by experts in overseas jurisdictions (particularly in Australia and the UK)[5] the Contracts and Commercial Law Reform Committee decided that the best approach for law reform in the area of credit transactions was to provide for a broadly based reform which would cover not only transactions which would previously have been classified as money lending transactions, but in fact practically all agreements which involved the extension of credit. The result of the Law Reform Committee's deliberations and report is legislation which has completely overhauled all aspects of credit financing in all of its forms. The new legislation swept away much of the established law and replaced it with an entirely new code.

Unsurprisingly, as the time grew ever nearer to the 1 June 1982 commencement date of the Credit Contract Act, the legal and accounting professions began to whip themselves into a foaming hysteria about the dire consequences that would ensue if the Act were allowed to come into force. By anyone's standards, the legal profession and others had ample time to make submissions both to

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5 Supra n.1. See collected references in Appendix II to the Report, pp. 197-199

the Law Reform Committee and to the Select Committee of Parliament. Despite this, the imminent collapse of the commercial credit industry and the impossibility, or at least the impracticability, of performing normal loan transactions was predicted by an ever growing chorus of dissent.

The tone of the times is caught beautifully in the following extract from an article[6] entitled, "The Credit Contracts Act - New Zealand's Frankenstein Monster":

> "On 1 June 1982 there will be delivered to the New Zealand public (largely now blissfully unsuspecting) a monster the like of which has not been seen anywhere else in the world - the Credit Contracts Act 1981. The astonishing thing is that this creature has not been nurtured in some murky back street or distant hamlet by a mad scientist, but has been lovingly sculptured and created quite legally and openly. Regrettably the main architects come from the legal profession, and if ever there was law for the lawyers (made by lawyers) this is it.
>
> The Act is incredibly complicated and is going to require an extraordinary amount of changes to well established commercial practices which have existed for a long period. It is going to be administratively expensive and, of course, the ultimate payer will the public. It is going to take years of litigation before any great degree of certainty evolves on many aspects of it. It is going to involve more people in stress in a word which is stressful enough. And the tragedy of it all is that it is really unnecessary.
>
> .... We all know we have got economic problems in this country but this Act certainly cannot help them. I am no economist but I can understand the simple fact that credit is a very necessary oil for the wheels of modern commerce and business. This Act seems to be doing its best to mix sand, or at least water, with the oil and neither do much to assist the

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6 W L Allan, (1982) NZLJ at 149

> smooth running of machinery. One commentator at the Law Society seminar actually said (jocularly no doubt) that this legislation was "a benefaction" for the legal profession. There is no denying that, and clearly the legal profession and the printing industry will do well out of the Act. They will be the only ones who will ...."

As a result of this last minute avalanche of opposition, a number of urgent amendments were incorporated in the Credit Contracts Amendment Act 1982 which also came into force on 1 June 1982, the same date as the Credit Contracts Act 1981.

The then Minister of Justice, the Honourable J K McLay, stated that the amendments were necessary to remove doubt from some areas of operation of the Act, but that he was confident that the overall structure and content of the Credit Contracts Act 1981 would provide a workable and effective solution to the problem of the regulation of credit transactions in New Zealand for the foreseeable future.

1 June 1982 came and went to a background music of professional teeth gnashing, but despite considerable uncertainty in some areas of operation of the Act at its outset, the apocalyptic vision of lawyers and accountants wandering dazedly through a blasted credit landscape clutching overheated calculators and murmuring the words "finance rate", between muffled sobs, did not eventuate.

3. MAIN FEATURES OF THE ACT

The preamble to the Credit Contracts Act 1981 states that it is an Act to reform the law relating to the provision of credit under contracts of various kinds in order to -

(a) prevent oppressive contracts and conduct;

(b) ensure that all the terms of contracts are disclosed to debtors before they become irrevocably committed to them;

(c) ensure that the costs of credit is disclosed on a uniform basis in order to prevent deception and encourage competition; and

(d) prevent misleading credit advertisements;

and to repeal the Money Lenders Act 1908.

To achieve the legislative objectives, the Act provides for the reopening of oppressive credit contracts, the disclosure of information on a uniform basis to all those obtaining credit, the regulation of credit advertisements and for the prohibition of certain financiers and certain terms in credit contracts.

Part I of the Act deals with reopening of oppressive credit contracts, and Part II deals with disclosure requirements. These two parts form the core structure of the Act. The other parts of the Act deal with advertising (Part III), prohibition of certain financiers and terms (Part IV), miscellaneous provisions (Part V) and consequential repeals, amendments and transitional provisions (Part VI).

In an effort to maintain uniformity and consistency in the regulation of credit contracts, section 52A of the Hire Purchase Act 1971 provides that the Credit Contracts Act is also to apply to hire purchase agreements, in addition to the provisions of the Hire Purchase Act 1971, and that neither Act is intended to limit the provisions of the other. As we shall see below, this shotgun marriage of inconvenience has spawned a host of problems in relation to disclosure of deferred payments dispositions (hire purchase contracts).

<u>Reopening of Oppressive Credit Contracts</u>

The core definition of credit contract is found in section 3(1)(a). This section defines a credit contract to be a contract under which a person provides or agrees to provide money or moneys worth in

consideration of a promise by another person to pay a sum or sums of money exceeding in aggregate the amount of the first mentioned money or moneys worth. Section 3(1)(b) extends this definition to include a contract under which a person forbears or agrees to forbear from requiring repayment of money owing in consideration of a promise by another to pay a sum or sums of money in the future which exceed in aggregate the original amount owing.

Section 3(4) shows that the legislation is intended to be concerned with function rather than form, as was the case under the Money Lenders Act 1908. Section 3(4) provides that -

> "Where, by virtue of any contract or contracts (none of which by itself constitutes a credit contract) or any arrangement, there is a transaction that is in substance or effect a credit contract, the contract, contracts or arrangement shall for the purposes of this Act be deemed to be a credit contract made at the time when the contract, or the last of those contracts, or the arrangement, was made, as the case may be." (Emphasis added)

It is almost ironic to find such a "substance over form" provision nestled in the bosom of such a technically drafted piece of legislation that it could be described as the high watermark of black letter law in the past decade.

The next important definition is that of "oppression". Section 9 defines oppressive to mean oppressive, harsh, unjustly burdensome, unconscionable or in contravention of reasonable standards of commercial practice.

Section 10(1) provides that the Court may reopen any credit contract where the Court considers that:

(a) the credit contract, or any term thereof is oppressive; or

(b) a party under a credit contract is exercised, or intends to exercise, a right or power conferred by the contract in an oppressive manner; or

(c) a party under a credit contract has induced another party to enter into the contract by oppressive means.

Recent case law[7] has determined that the definition of oppression requires something more than unfairness. That there must be a sufficiently serious element of unfairness to merit reopening a contract Factors to be considered are the relative status of the parties, the nature and extent of the default, the way in which the default arose, the impact on the borrower, the attitude of the lender, the existence of a collateral purpose and the general appearance of the contract throughout. Clearly this is wider than the equitable doctrine of unconscionable bargains which appears to be restricted to a situation where one party to a transaction is at a a special disadvantage in dealing with the other party because of illness, ignorance, lunacy, inexperience, financial need or other circumstances such that that person's ability to protect their own interests is severely impaired and the other party takes unfair advantage of the situation. Such a widening of the concept of unconscionability is to be expected in remedial legislation such as this.

If the Court considers that there is a credit contract and that any term or the exercise of any power or any act thereunder is oppressive, or that a party has been induced by the other party to enter into the credit contract by oppressive means (section 10), then as long as proceedings to reopen the credit contract are instituted not more than 6 months after the date on which the last obligation to be performed under the contract is performed then the Court may re-open the contract (section 12). Upon reopening, the Court has a wide discretion to provide a just resolution of the dispute (section 14).

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7 See Shotter v Westpac Banking Corporation [1988] 2 NZLR 316, 342; Didsbury v Zion Farms Ltd (1989) 1 NZ ConvC 190, 229 at 190, 238.

The limitation of six months contained in section 12 is clearly intended to maintain a degree of commercial certainty, while also providing a reasonable period within which people who feel that they have been aggrieved may take action.

Disclosure Requirements

The disclosure regime only applies to "controlled credit contracts", a sub-species of credit contract. "Controlled credit contract" is defined in section 15 of the Act as a credit contract:

(a) Where the creditor, or one of the creditors, for the time being is a financier acting in the course of his business; or

(b) Which results from an introduction of one of the parties to the contract to another such party by a paid adviser; or

(c) That has been prepared by a paid adviser.

The distinction between a credit contract simpliciter and a controlled credit contract is critical. While it is necessary to define the basic credit contract expansively in order to bring a wide range of contracts within the unconscionability provisions, and thus subject them to the reopening regime, common sense, policy, and commercial practicality dictated that a further subcategory of contract denoted by the term "controlled credit contract" be created and subjected to the further rigours of the disclosure regime.

It can be seen from section 15 that the essence of the distinction between the two terms is that a controlled credit contract is one where a professional financier or a paid adviser has been involved in the credit transaction. The rationale behind this is that the Act is designed, in part, to redress the apparent inequality of bargaining power, commercial sophistication and knowledge between people whose business is the provision of finance, and ordinary members of the public. It would be inappropriate to impose the disclosure

regime in a situation where the balance of power and knowledge was relatively equal between the parties. Also, only professional lenders are capable of complying with the Credit Contracts Act disclosure regime, and the comparative credit shopping objective of the Act "implicates" primarily professional lenders. This demonstrates that the focus of the Act is fairly and squarely upon redressing inequalities of bargaining power in the credit marketplace.

Given this primary focus, it is perhaps surprising that the Act has not been limited to "consumer" transactions. New Zealand is unique in the world in subjecting commercial transactions (i.e. transactions between "business people") to a "truth in lending" regime.

Consistently with this philosophy, section 15 contains a number of categories of credit contract which are excluded from the more onerous definition of controlled credit contract.

Section 15(1) paragraphs (d) - (m) specify those credit contracts which are not to be controlled credit contracts, regardless of whether a creditor is a financier, or a paid adviser has introduced the parties or prepared the contract. These paragraphs provide as follows:

> "(d) A contract where every debtor for the time being is -
>
> (i) A financier by virtue of either paragraph (a) or paragraph (c) of the definition of that term; or
>
> (ii) The Crown, a local authority, or a Government agency; or
>
> (iii) A body corporate that has a paid up capital of not less than $1,000,000; or a body corporate that is related to such a body; or

(e) A contract where every party to the contract for the time being is a body corporate that is related to every other such party to the contract; or

(f) A contract if the total amount of credit outstanding under that contract and under all other contracts between the same creditor and debtor is or will be not less than $250,000; or

(g) A contract that results from an offer of securities to the public within the meaning of sections 2 and 3 of the Securities Act 1978; or

(h) A contract the only effect of which is to modify the terms of a controlled credit contract; or

(i) A contract entered into pursuant to a revolving credit contract; or

(j) A contract entered into pursuant to a registered superannuation scheme; or

(k) A contract that forms part of a transaction involving the export from New Zealand, or the import into New Zealand, of goods or services and that is entered into for the purpose of facilitating the export or import of those goods or services; or

(l) An agreement to which sections 5 and 7 of the Door to Door Sale Act 1967 apply; or

(m) A contract of a kind specified in regulations made under section 47(1)(d) of this Act.

The categories of credit contract exempted from the definition "controlled credit contract" exemplify situations either where the parties can be presumed to be able to take care of themselves (paras d, e and f), where policy or commercial workability dictate that the

applicability of the disclosure regime would be inappropriate (para k), or where alternative disclosure regimes apply (paras. g, j and l).

The essence of the disclosure requirements then, is the desire by the legislature to provide for the "person in the street" to be able to shop around in an informed matter for the best credit terms possible. To this end, two key terms relating to disclosure are "total cost of credit", and "finance rate".

Total cost of credit is defined by section 5(1) in relation to a credit contract to mean the total of all money and moneys worth that the debtor has paid or provided or is or may become liable to pay or provide either by virtue of the contract, or to or for the benefit of the creditor in respect of the contract, less certain amounts, such as, obviously, the amount of credit provided, and also, importantly, the amounts specified in section 3(3)(b) of the Act.

These excluded amounts relate to incidental services (section 3(3)(b)(i)) and other matters where it can reasonably be said either that extra value is added to the contract above and beyond what would normally be regarded as purely a credit charge for compensation for being kept out of one's money over time (and which could also apply in a cash sale transaction), or when the amount cannot reasonably be classified as a charge for credit, e.g. any reasonable amount payable as a result of a default under the contract by the promisor (section 3(3)(b)(ii).

The term "finance rate" is defined in section 6 as being the rate that expresses the total cost of credit as a percentage per annum of the amount of credit, and is either the annual finance rate, as defined in the First Schedule to the Act, or a rate correctly derived from tables prepared by the Government Actuary to produce the annual finance rate for the type of credit contract being considered. Both are calculated using the actuarial method.

What this serpentine maze of definitions is intended to achieve is to provide the true cost of credit to the debtor in a uniform fashion. If this is expressed as a finance rate and all other providers of credit

are required by the Act to provide the potential debtor with a uniformly calculated finance rate, then it is a simple operation for the debtor to compare the numbers and pick the lowest finance rate to get the best deal. However, the finance rate is not the only factor considered in comparative shopping. Some consumers would look at cash flow aspects and prefer a higher finance rate contract with a longer pay out period to a lower finance rate contract with a shorter payout period. Further, many people will already have made a decision before disclosure is made!

While clearly this credit-shopping rationale is fine in theory, in practice it is highly unlikely that Mr or Mrs X shopping for a waste disposal unit on a Friday night who finds a unit basically to their liking, is going to spend the week trudging around town to find the best finance rate available. Given the inherent unlikelihood that the people whom the Act is intended to benefit most will have the knowledge or inclination to take advantage of the Act, perhaps a major rationale for the disclosure regime disappears, particularly in view of the fact that, typically, initial disclosure of, for example, a hire purchase contract for a waste disposal unit, including the finance rate, will not take place until some days <u>after</u> the purchase has been concluded!

Four types of disclosure are provided for by Part II of the Act:

(1) initial disclosure;

(2) modification disclosure;

(3) continuing disclosure (of revolving credit contracts);

(4) request disclosure.

The objectives of disclosure can be stated to be:

(a) to enable comparison of various credit sources available;

(b) to enable a borrower to make a choice between buying on credit or paying cash;

(c) to ensure that potential debtors are aware of their rights and obligations under the credit contract;

(d) to ensure that at any time during the term of a credit contract a debtor is able to ascertain the exact terms of that credit contract and his or her obligations thereunder.

In relation to the time before a Credit Contract Act becomes binding, the Act provides a three day "cooling off" period after initial or modification disclosure has been made when the debtor can theoretically sit back and decide if they want to continue with that contract (section 22).

Given that the purpose of initial disclosure is to facilitate comparison shopping for credit, the rational use of credit compared with buying for cash, and to ensure prior familiarity with the terms of credit transactions, it does not seem particularly rational to attempt to achieve this by giving a three day cooling off period. One may well ask why a person shopping for credit could not "do the rounds" before deciding to enter into a binding contract. Presumably, the legislature envisaged that in the cold light of morning a potential debtor would be focused and sufficiently motivated to engage in this largely mythical credit shopping exercise by exercising his or her rights under section 22 to cancel a controlled credit contract which does not appear to be as affordable or favourable after full disclosure has been made.

It should also be noted that, by virtue of section 22(2), the same level of "cooling off" protection is not extended to purchasers under a deferred payment disposition, because in order to take advantage of this provision and cancel the credit provisions of the contract, the purchaser must be able to pay the cash price for the relevant property or services, up front! For major and expensive whiteware, or other similar consumer items, the prospective purchasers will

usually not have the cash immediately to, in effect, buy themselves out of the contract.

In relation to post-contract formation disclosure, there are three categories of disclosure. The first category of post contract disclosure is modification disclosure where there is provision for the terms of controlled credit contracts which are modified or varied to also be disclosed (section 17). Secondly, in relation to revolving credit contracts (such as credit cards), there is continuing disclosure where, within a certain time after the end of each billing period certain key terms of the revolving credit contract are disclosed to keep the debtor aware of his or her credit position. The final category is request disclosure, where a debtor or guarantor under a controlled credit contract may request in writing that the creditor disclose essential particulars described in the Act.

<u>Penalties for Non Compliance</u>

Failure to comply with the disclosure provisions can result in a loss to the creditor of part or all of the total cost of credit which remains payable under the contract (sections 25 to 28).

Typically these sections provide for the liability of every debtor and guarantor under the controlled credit contract to be extinguished for "a specified amount" if the relevant form of disclosure has not been made. The "specified amount" is the smaller of:

(a) An amount equal to three times the part of the total cost of credit that relates to the period from the day the contract [or modification contract] is made until the earlier of the following days:

(i) The day on which [initial or modification] disclosure is made:

(ii) The day that is 8 months after the day the contract [or modification contract] is made:

(b) The total cost of credit payable under the contract [in the case of failure to make initial disclosure]

or

(c) The total cost of credit payable under the modified credit contract in respect of the period from the day the modification contract is made until the day on which the modified credit contract expires [in the case of failure to make modification disclosure]

or

(d) The day the contract expires [in the case of failure to make request disclosure].

In respect of request disclosure the beginning of the period from which potential extinguishment of credit charges liability applies is the time that the specified fee is received by the creditor. If failure is made to make request disclosure in respect of a revolving credit contract the cost of credit which is liable to extinguishment is three times the total cost of credit payable under the contract in respect of the last completed billing period before the request is made.

As can be seen by the above provisions, the potential forfeiture of three times the total cost of credit for a given period, until proper disclosure is made, is a punitive device to ensure that proper disclosure is made by the creditor without further delay. This "triple damages" incentive approach is, however, subject to the palliative provisions in sections 31 and 32.

It is notable that if there is a failure to make continuing disclosure in respect of a revolving credit contract for any billing period then the debtor's liability to pay the total cost of credit in respect of that billing period is extinguished (section 27(a)). It is not immediately apparent why the extinguishment is not for three times the total cost of credit for that billing period, as is the approach in relation to initial, modification and request disclosure.

This is particularly puzzling since section 28(2)(a) provides that in relation to a failure to make request disclosure of a revolving credit contract the creditor is liable to forfeit three times the total cost of credit payable in respect of the last completed billing period before the request is made.

For the sake of consistency it is submitted that section 27(a) should be amended to also provide for the extinguishment of three times the total cost of credit for the relevant billing period.

Relief from Penalties for Non-Compliance

There are a number of grounds upon which a creditor may be entitled to relief for non disclosure (section 31). Section 32 also provides a general ameliorating provision whereby the Court may, on the application of the creditor, make various orders to reduce the penalty that the creditor would otherwise suffer.

Sections 31 and 32 provide:

Section 31 Relief For Inadvertent Non-Disclosure

31 Sections 24 to 28 of this Act shall not apply in respect of a failure to make initial disclosure, modification disclosure, continuing disclosure, or request disclosure of a controlled credit contract or modification contract (as the case may be) if the creditor shows that -

(a) The failure was due to inadvertence or to events outside the control of the creditor; and

(b) Disclosure was made as soon as reasonably practicable after the failure was discovered by the creditor or brought to his notice; and

(c) Where disclosure documents relating to the contract state as the finance rate of the contract

a rate that is less than the correct finance rate, the creditor has reduced the finance rate of the contract to the rate disclosed in those documents; and

(d) The creditor compensated or offered to compensate the debtor under the contract for any prejudice caused the debtor by the failure.

Section 32 Power of Court to Reduce Penalty

32(1) [Order] The Court may, on the application of a creditor under a credit contract, order -

(a) That any of sections 24 to 28 of this Act shall not apply in respect of a credit contract, or modification contract, or any class or classes of such contracts; or

(b) That an amount for which liability has been extinguished pursuant to any of those sections be reduced to an amount specified by the Court.

32(2) [Criteria] In deciding whether to make such an order, the Court shall have regard to the following matters:

(a) Whether the creditor is a financier;

(b) The extent of, and the reasons for, the non-disclosure;

(c) The extent to which a debtor or guarantor has been prejudiced by the non-disclosure;

(d) Such other matters as the Court thinks fit.

32(3) [Conditions] Any order under this section may be made on such terms and conditions as the Court thinks fit.

It is clear, particularly from section 32, that the framers of the Act wished to preserve as much flexibility as possible to do justice between the parties, while putting the onus firmly on the creditor to make out a good case for relief from the penalty provisions contained in sections 25 to 28. These provisions are clearly a major improvement over the draconian, absolute and inflexible penalty provisions contained in the Money Lenders Act 1908.

4. SELECTED LEGAL PROBLEM AREAS

The problem areas that I have selected for discussion are:

(a) the correct interpretation of section 15(1)(f);

(b) the necessity for disclosure to guarantors; and

(c) the correct interpretation of section 3(3)(b)(ii).

Each of these areas will now be discussed in turn and reform proposals formulated to cure the perceived deficiencies in each area.

(a) Section 15(1)(f):

What is the current law?

The first issue is the correct interpretation of section 15(1)(f).

The section provides that the term "controlled credit contract" does not include:

> A contract if the total amount of credit outstanding under that contract and under all other contracts between the same creditor and debtor is or will be not less than $250,000

The correct interpretation of the section is of great importance because if the exclusion can be relied upon then the contract is not subject to the disclosure requirements contained in Part II of the Act. It should be noted, that if the contract is a credit contract (but not a controlled credit contract) then it is still subject to the re-opening provisions contained in Part 1 of the Act.

The Act

The section is ambiguous. The following interpretations are possible:

1. The exclusion applies and continues to apply to the contract if $250,000 is advanced at the time the contract is entered into, or subsequently (pursuant to a mutually binding obligation contained in the contract), notwithstanding that the total amount of credit outstanding may subsequently be reduced to below the $250,000 level by repayments, some form of set-off available to the debtor, or debt forgiveness.

2. If at any time during the term of the contract the total amount of credit outstanding falls at any time below $250,000 then the contract immediately becomes a controlled credit contract which is subject to the disclosure provisions.

3. If there are a number of existing controlled credit contracts between the parties and the total amount of credit outstanding is less than $250,000, but a further credit contract is entered into which increases the total amount of credit outstanding under all contracts to more than $250,000 then only the final contract which tips the scales over $250,000 is not a controlled credit contract.

A key term in the section is "total amount of credit". While this is not defined (unlike "total cost of credit, which is defined in section 5), "credit" is defined in section 2(1) to mean:

(a) In relation to a credit contract of the kind specified in section 3(1)(a) of this Act......, the money or money's worth provided or agreed to be provided;

(b) In relation to a credit contract of the kind specified in section 3(1)(b) of this Act, the money, payment of which is forborne or agreed to be forborne;

(c) In relation to a credit contract of the kind specified in paragraph (d) or paragraph (e) of section 3(1) of this Act, the cash price of the property, services, or goods, less the following amounts:

(i) the amount of any deposit paid at or before the time of the making of the contract;

(ii) the amount of any trade-in allowance agreed on;

and "amount of credit" includes any amount which is provided to the debtor to meet any of the expenses coming within section 3(3)(b) of this Act or which is disbursed or deducted by the creditor to meet any of those expenses.

For the purposes of this paper only para (a) is relevant.

Section 3(1) defines "credit contract" to mean:

(a) a contract under which a person provides or agrees to provide money or money's worth in consideration of a promise by another person to pay, or to procure the payment of, in the future and in respect of the

provision, a sum or sums of money, exceeding in aggregate the amount of the first-mentioned money or money's worth; or

(b) a contract under which a person forbears or agrees to forbear from requiring payment of money owing to him in consideration of a promise by another person to pay, or to procure the payment of, in the future and in respect of the forbearance, a sum or sums of money exceeding in aggregate the amount of the first-mentioned money;

and without limiting the generality of paragraphs (a) and (b) of this subsection, includes:

(c) a contract under which a person lends or agrees to lend money in consideration of a promise by another person to pay, or to procure the payment of, in the future and in respect of the loan, a sum or sums of money exceeding in aggregate the amount of loan ...

Section 3(1)(c) is a sub-species of contract which is already covered by the general para (a). It is unclear why the drafter of the section considered it necessary to specifically include a reference to a loan contract (para (c)) when, it is submitted, there is no doubt that it is already covered by para (a). (Both paras (a) and (c) appear wide enough to cover contracts of loan and guarantee, the latter because both paragraphs are drafted in such a way that it is not necessary for the credit to be extended to the same person that provides the promise to pay, or to procure the payment of, a greater sum in the future).

As we have already seen, the definition of "credit", in relation to a contract of the kind covered by para (a) means "the money or money's worth provided or agreed to be provided".

By applying this definition to section 15(1)(f) it can be argued that a credit contract would be excluded from the category of controlled credit contract if the total amount of the money provided for or agreed to be provided under that contract (and under all other contracts between the same creditor and debtor) is, or will be, not less than $250,000.

So, it could be argued that if $250,000 credit is immediately advanced pursuant to the contract, or that single or multiple drawdowns totalling not less than $250,000 will definitely be advanced in the future, then the contract is not a controlled credit contract, regardless of whether at some time during the life of the contract the total indebtedness falls below the $250,000 threshold.

The presence of the word "outstanding" in section 15(1)(f) needs to be considered in relation to the definition of "credit" which we have now established applies to contracts of loan (under section 3(1)(a) and 3(1)(c)). It seems that when the applicability of the exemption contained in section 15(1)(f) is being considered in the context of a credit contract within the definition contained in section 3(1)(a) and (c) then the concept of "credit outstanding" becomes redundant because "credit" in relation to a loan contract is defined as "the money ...... provided or agreed to be provided". To make sense of the provision, "outstanding" must be read as "advanced or agreed to be advanced".

The opposing argument is that the word "outstanding" should be given its plain and ordinary meaning of "due and owing" and, when read with the words "is or will be", requires an outstanding credit balance of at least $250,000 to be maintained throughout the term of the contract if it is to remain excluded from the category "controlled credit contract".

It is suggested that this argument is not persuasive. If this interpretation was correct then only credit contracts under

which interest only was repayable periodically throughout the term of the contract (e.g. flat, as opposed to table mortgages) would not metamorphose into controlled credit contracts at some point during that term. In any type of credit contract, other than one under which interest only was payable during the term of the contract (until the final instalment, when all of the principal, as well as the final instalment of interest, is due) periodic principal repayments would, necessarily, reduce the outstanding balance of the "total amount of credit" to less than the $250,000 "trigger"!

Another powerful supporting argument in favour of the interpretation that the total amount by credit outstanding only needs to be at least $250,000 when the contract is made (or there is a mutual obligation that $250,000 be advanced at a later date or dates) and that future repayments which reduce the outstanding credit balance to less than $250,000 are irrelevant for the purposes of section 15(1)(f) is that section 16 provides for initial disclosure to be made either:

(a) before the contract is "made"; or

(b) not later than 15 working days after the contract is made.

The choice of time of disclosure provided by section 16 could arguably explain the use of the words "is or will be not less than $250,000" in section 15(1)(f).

The words "or will be" have not been included in section 15(1)(f) to add a requirement that an outstanding credit balance can never be less than $250,000 (if it was at least $250,000 when the contract was entered into or when the initial disclosure is made in respect of a sum of credit of at least $250,000 before the contract is made. (Section 16(1)(a)). Clearly, if disclosure is made before any contractual obligations arise then there is, at that point, no credit outstanding and consequently the words "or will be"

anticipate the making of a loan contract of at least $250,000. So, the words "or will be" in section 15(1)(f) have been included to recognise that disclosure will often be made before a binding contract is entered into such that it is only at some time after disclosure has been made that any credit will be outstanding.

A further argument in favour of the interpretation set out above derives considerable additional support from section 16. As stated above, initial disclosure is contemplated either before the contract is entered into or within 15 working days of the contract being entered into. If a credit contract could "become" a controlled credit contract during the term of a loan at any time when the credit outstanding fell below $250,000, if only for a short period, then, in theory, initial disclosure would be required. However, reading section 15(1)(f) in this way makes a nonsense of section 16, which cannot, by its terms apply unless a very strained interpretation is adopted whereby a credit contract does not metamorphose into a controlled credit contract when the level of debt falls below $250,000. Rather, to make any sense of attempting to apply the initial disclosure regime contained in section 16, it would have to be held that an entirely new contract arises, which necessitates initial disclosure. It is submitted that such an artificial interpretation is difficult to sustain.

From the foregoing, it is submitted that if a contract specifies that at least $250,000 is to be advanced in a single drawdown either immediately or at some later date (and such a sum is in fact drawn down) then the exemption in section 15(1)(f) may be relied upon. The fact that there may be less than $250,000 of debt due at some time during the term of the contract is irrelevant. The crucial time in relation to the obligation to make the advance is the time when the contract is entered into, regardless of whether the full $250,000 is drawn down in one hit, or in progressive tranches.

At the least, it can be said that the intent behind the section is uncertain.

The "Literature"

D F Dugdale,[8] in his commentary on section 15, states:

> Paragraph (d). The philosophy of this provision is that some debtors can be expected to be able to look after themselves. There are excluded from the category of "controlled credit contracts" under which the debtor is himself a financier, the Crown, a local authority, a Government agency, a body corporate with a paid up capital of a million dollars or a related body corporate ......".
>
> Paragraph (f). Contracts where the amount advanced (taking into account other contracts between the same parties) is not less than $250,000 are excluded from the definition of controlled credit contract. There is no provision for varying this figure to take account of inflation, and if the value of New Zealand currency continues to depreciate it may well be found that this paragraph allows the most significant gap in the protection afforded by Part II.
> (emphasis added)

It is clear that the philosophy that "some debtors can be expected to look after themselves", which Dugdale applies to the exclusion contained in para (d), is equally applicable to para (f).

It is also noteworthy that Dugdale refers to "the amount advanced" (emphasis added) being not less than $250,000, not the amount outstanding. As a member of the Contracts and Commercial Law Reform Committee which produced the Report from which the Act eventually emerged (albeit in

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8 Dugdale D F, The Credit Contracts Act 1981, Butterworths, Wellington, 1981

a form which did not follow all of that Committee's recommendations), it is indicative of the intention behind the provision that the author uses this term to paraphrase the thrust to paragraph (f).

Professor D W McLauchlan has stated in relation to the Act in a 1984 article[9]:

> What is the justification for imposing formal disclosure requirements where businessmen enter into large scale financing transactions involving say, $200,000? No other country in the word does so. They all employ one or more of a variety of techniques to limit disclosure to consumer transactions ....
>
> I would like to see the present exemption from the Act's disclosure requirements of transactions involving $250,000 or more lowered to a more realistic figure of $50,000 - and even that is high in comparison with overseas legislation.
>
> The Credit Contracts Act is supposed to be essentially a consumer protection measure. Its main aim is to redress the inequalities between credit providers and those who use credit for private purposes.

Professor McLauchlan's comments appear to proceed from an assumption (shared by Dugdale) that transactions involving $250,000 or more are exempt from the disclosure requirements of Part II of the Act, whether or not the level of credit due falls below $250,000 at any time during the term of the loan, as it often will in relation to loan advances to small/medium businesses where regular, periodic repayments of principal and/or interest are made.

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9 McLauchlan D W, Contract & Commercial Law Reform in New Zealand, (1984) 11 NZULR 36 at 62-63

All of the overseas legislative examples cited by Professor McLachlan[10] to illustrate devices which are used to limit the application of consumer credit legislation are framed on the basis that transactions where the amount involved/credit extended exceeds a certain figure are excluded.

It is also significant that Dugdale[11] discusses whether a credit contract can change its character to become a controlled credit contract and vice versa:

> Can a credit contract during its life change its status from controlled credit contract to credit contract or vice versa? What for example is the position if the creditor under a credit contract (not a controlled credit contract) assigns his interest to a financier? The use of the words "for the time being" (rather than such words as "when the contract is made") in paragraphs (a), (d) and (e) and s.18(1) suggest that a credit contract can so change its status.

What is significant about Dugdale's comment is what it does not say. He does not even consider the possibility that contracts outside of paras (a), (d) or (e) could be mutable.

However, it has been suggested by D M Forsell[12], in relation to paragraph (f), that a contract can change its character:

> By virtue of s.15(1)(f) of the Act "a contract, if the total amount of credit outstanding under the contract and under all other contracts between the said creditor

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10 See footnotes supra n. 9 at p. 62 footnote 15. Most of the Acts cited have been subsequently amended by increasing the "cut-off" amount to recognise the effect of rampant inflation on the real value of money. However, none of the Acts have increased the threshhold sums in "real" terms, only inflation-adjusted them.

11 Supra n. 8

12 Forsell D M, A Few Comments on the Credit Contracts Act 1981, (1982) NZLJ 219, at 219-220

> and debtor is or will be not less than $250,000" is not a controlled credit contract.
>
> If, pursuant to a credit contract between a debtor and a creditor, "the amount of credit outstanding" fluctuates so that at some times it is $250,000 or more and at other times less than $250,000, it seems that there is a corresponding fluctuation in the nature of the contract from controlled to uncontrolled and from uncontrolled to controlled.

It is submitted that the better view is that of Dugdale, who proceeds from the assumption that the only relevant time to access exclusion from or inclusion in the category "controlled credit contract" is when the amount of credit is actually advanced. Subsequent repayments are therefore irrelevant because a "debtor who can be expected to look after himself" doesn't suddenly become less able to do so after repaying $100,000 of an initial $250,000 advance!

The apparently deliberate use of that troubling word "outstanding" still leaves one unable to state with absolute certainty which is the correct interpretation of section 15(1)(f).

The Cases

Two recent cases discuss this issue.

In Jenkins[13] v NZI Finance Limited Tompkins, J stated:

> Disclosure
>
> The third cause of action pleads that the mortgage was a controlled credit contract, within s.15 of the Credit Contracts Act 1981, and that NZI did not make

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13 Unreported. M 320/87, Hamilton Registry, 23.8.88

available to Mr and Mrs Jenkins the disclosure documents required by s.21.

Section 15(1) provides that the term "controlled credit contract" means a credit contract, inter alia where the creditor is a financier, acting in the course of its business. NZI is within that definition. But subs (1) also provides that the term does not include:

> "(f) a contract if the total amount of credit outstanding under that contract and under all other contracts between the same creditor and debtor is, or will be not less than $250,000."

Mr Hassall submitted that the mortgage was not within that exception because there was nothing in the mortgage to show that the amount owing under any advance made pursuant to the March facility, would be not less than $250,000. In that respect he is correct. The March facility provides that the total amount of all advances made under it "shall not exceed $500,000" and that each advance under the facility "shall be not less than $50,000". Quite clearly then, it would be possible for the amount advanced under the facility to be less than $250,000.

But that, in my view, does not take the mortgage out of the exception. It applies if the total amount of credit outstanding is, or will be, not less than $250,000. The evidence establishes that as a matter of fact the total amount of credit outstanding was more than $250,000. It is the actual amount of credit outstanding that is determinative, not what, under the terms of the contract, could have been the amount of credit outstanding.

Mr Hassall submitted that as at 8 May 1986 [the date the mortgage was executed], there was only

> outstanding under the March facility, $89,247.81, being the amount that was paid to M B Jenkins Limited that day. He submitted that the earlier payment of $410,752.19, made on 4th February 1986, could not be an amount outstanding under the March facility because it was made before the March facility was executed. I do not accept this submission. It is apparent from Mr Heapy's evidence, that the payment was being made because Head Office had authorised the facility and in anticipation of it being accepted. Once the March facility was completed, then that amount, as well as the amount paid on 6th March 1986, became the total amount of credit outstanding under that contract. (Emphasis added)

It is clear from His Honour's comments that for section 15(1)(f) to apply, the total credit outstanding under the facility would have to be at least $250,000. In this case there was a facility made available up to a limit of $500,000 and the Judge recognised that the mere availability of credit over $250,000 was not enough to bring the contract within the exemption. There was only the promise by the creditor to make up to $500,000 available if the debtor so requested, but no binding agreement to provide any credit at all unless a request was made.

His Honour's comment that it would be possible for the amount advanced under the facility to be less than $250,000 is related to the time the mortgage contract was executed, i.e. 8 May 1986. It was his view that it is the actual amount of credit advanced at the time the credit contract is entered into (or the amount that will ultimately be advanced by virtue of a legally enforceable obligation) that is the determining factor. At the least therefore, it can be asserted with some confidence that the Judge's comments are not in direct conflict with the interpretation argued for in this paper.

The other case which bears on this issue is Buckland v Landbase Securities Limited (In Liquidation).[14] Anderson J states:

> It is argued on behalf of the defendant that here was a contract in respect of which a credit would be not less than $250,000, it being common ground that only approximately $200,000 capital was drawn down. I do not accept that argument. The evidence of the contract before me shows that the total amount of credit outstanding might have become in excess of $250,000 but there was no contractual obligation on the part of the plaintiff to drawn down more than the initial advance of $66,000, coupled with a right to call on the defendant to advance up to $270,000. The situation is that although the defendant could not have resisted calls to the extent of $270,000, the plaintiff could have resisted the enforcement of a loan leaving him indebted to the extent of $270,000. It is perfectly plain that the total amount of credit outstanding might have become more than $250,000 but was not bound in terms of the contract to attain that level. Accordingly, the Credit Contracts Act applies. (Emphasis added)

Like Jenkins,[15] Buckland is not dispositive of the interpretation issue under consideration, but again, there are tantalising hints, particularly in the last (highlighted) sentence of Buckland that what is important is the amount initially advanced or in respect of which there is a contractually binding commitment on both the creditor and the debtor to lend and borrow a sum of at least $250,000.

A final issue relates to the situation where there are a number of controlled credit contracts between the creditor and the debtor and the $250,000 cut-off must be assessed. Once the

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14 Unreported. CP 2604/89, Auckland Registry, 11.4.91 at p. 5

15 Supra n. 13

threshold is crossed are all of the constituent controlled credit contracts together to be regarded as no longer controlled credit contracts, or only the final contract that tips the combined contracts over the $250,000 threshold?

A plain reading of section 15(1)(f) indicates that only the last of these contracts would be excluded from the category of "controlled credit contract". Why this should be so is not readily apparent if it is accepted that people borrowing $250,000 or more, whether by one, or a series of credit contracts, are still capable of looking after themselves!

CONCLUSIONS

1. For the reasons given above, it is submitted that the correct interpretation of section 15(1)(f) is that a credit contract is excluded from the definition of "controlled credit contract" if the following conditions are met:

   (a) at least $250,000 is advanced when the contract is made; or

   (b) at least $250,000 will definitely be advanced [in a single drawdown or in multiple drawdowns] at some time after the contract is made;

   (c) if there are already one or more credit contracts between the same creditor and debtor, and the amount of credit outstanding is less than $250,000 and a new contract is then entered into which raises the level of credit to $250,000 or more then only the last of these contracts would fall within the exclusion contained in section 15(1)(f).

2. In respect of conclusions (a) and (b) above the fact that the level of credit outstanding subsequently falls

below $250,000 would not necessitate the reclassification of a credit contract as a controlled credit contract such that the disclosure provisions of Part II of the Act would apply.

In relation to conclusion (c), this conclusion holds only in respect of the contract that takes the credit outstanding over the $250,000 level, and, ipso facto, all subsequent credit contracts between the parties.

In my view these propositions are supported by an interpretation of the Act, by the legal literature available, by the mechanisms utilised in overseas legislation to distinguish consumer credit transactions from commercial transactions, and by an application of common-sense, bearing in mind the aims, objectives and policies which the Act was intended to implement.

RECOMMENDATIONS

It is clear that there is a level of uncertainty in relation to the correct interpretation of section 15(1)(f).

For the reasons given in this paper I recommend that the section be amended to make it clear that if at least $250,000 [or some other appropriate figure] is to be advanced under the contract, regardless of whether at some point the amount of credit outstanding drops below $250,000 [or some other appropriate figure], then the contract should be excluded from the category of "controlled credit contract" and the disclosure requirements in Part II of the Act should not apply.

If there are a number of credit contracts involved and the $250,000 limit is exceeded then the exemption should be applied to all such contracts, not just the one which tips the total over $250,000, and all subsequent contracts.

(b) The necessity to disclose to guarantors

The recent case of Feltex Modular Carpets Pty Limited v. Day and Another[16] has reignited the issue of whether the Credit Contracts Act 1981 requires disclosure to be made, under s.16, to guarantors of debts owing under controlled credit contracts. Unfortunately, Feltex has not clarified the law and authoritatively settled the considerable divergence of judicial opinion concerning this issue.

Discussed below are the cases, including Feltex, which have considered this question. In general, these cases have failed to distinguish adequately between two separate questions:

> whether a guarantee can be, or can be part of, a controlled credit contract; and
>
> whether disclosure should be made to a guarantor who is not a debtor for the purposes of the Credit Contracts Act.

While the answer to the first question is, at least sometimes, "yes", the answer to the second question, is "no". Those cases in which the answer to the second question has been given as "yes" have failed to distinguish the two questions defined above, and appear to have decided that disclosure is required to guarantors because the guarantees concerned have been (part of) credit contracts regardless of whether the guarantors under those guarantees have also fallen under the definition of a "debtor" contained in the Act.

It is clear from the Act, however, that a guarantor is not the same thing as a debtor. Both terms are separately defined in section 2 of the Act:

> "Debtor", in relation to a credit contract, means a person to whom credit is, or is to be, provided

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16 (1992) 4 NZBLC 102 649 (Master Williams)

pursuant to the contract; and, except in section 16 of this Act, if the rights of such a person are transferred by assignment (whether absolutely or by way of mortgage) or operation of law, includes the person for the time being entitled to those rights:

"Guarantor", in relation to a credit contract, means a person who guarantees the performance of a debtor's obligations under the contract, or who indemnifies a creditor against any loss which he may incur in respect of that contract, or who assumes liability for performing the obligations of a debtor under the contract; and "guarantee" has a corresponding meaning.

As can be seen, a debtor is defined in section 2 as, essentially, a person to whom credit is or is to be provided. A guarantor, on the other hand, is defined as a person who guarantees the performance of a debtor's obligations or who indemnifies a creditor against any loss. Guarantors and debtors are, therefore, clearly distinguished by the Act.

A debtor is not defined as someone who owes money under a credit contract, a definition which could arguably include a guarantor. Rather, a debtor is defined as a person to whom credit is provided, which does not, (at least ordinarily) include a guarantor of a third party's debt obligations;

Sections 16 to 19 provide for four different forms of disclosure (in turn, initial, modification, continuing (in relation to revolving credit contracts) and request disclosure). Under ss.16 to 18, disclosure is required to be made "to every debtor for the time being". Request disclosure under section 19, however, must be made to any "debtor or guarantor" who so requests. The disclosure provisions themselves, therefore, explicitly distinguish between disclosure to debtors and disclosure to guarantors.

What the Law Is

Despite this clear statutory dichotomy between debtors and guarantors, however, some judges have interpreted the Act to require disclosure to guarantors in situations beyond those where a request for disclosure has been made by a guarantor under section 19.

In UDC Finance Limited v. Lloyd[17] the plaintiff, a finance company, sued the first defendant and the second defendant in respect of an advance made by the plaintiff to the second defendant on 20 December 1985. Summary judgment was entered against both defendants for the sum claimed plus interest and costs. The claim against the first defendant was based on his guarantee of the second defendant's loan. The loan was made to enable the second defendant to purchase an aircraft from the first defendant's company. The second defendant gave an Instrument by way of Security over the aircraft to the plaintiff. The loan moneys were paid by the plaintiff to the first defendant by direction of the second defendant, to effect the second defendant's purchase of the first defendant's aircraft.

Following the entry of judgment the first defendant filed an application to set aside the summary judgment on the grounds, inter alia, that the contract of guarantee was "invalidly disclosed" to the first defendant contrary to sections 16 and 20 of the Credit Contracts Act 1981 and the Second Schedule thereto.

Wylie J. held that disclosure was not required to be made to a guarantor. However, he based this conclusion on his finding that a guarantee is not a credit contract within the meaning of the Act, from which his Honour concluded that it followed that no disclosure was required because disclosure only has to be made in relation to a credit contract which is a controlled credit contract. However, it is submitted that this

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[17] Unreported. CP 297/86, Auckland Registry, 16.9.86

analysis fails to clearly distinguish between the two separate questions identified above; whether a guarantee is a credit contract, or, together with other documents, is a credit contract, and whether a guarantor is a debtor, as defined in the Act.

Wylie J. gave five reasons for his conclusion that disclosure was not required to be made to the guarantor in this case:

1. "Apart from such artificialities as may be imposed by virtue of the statutory definition, a guarantee is not a contract for credit in the ordinary and natural sense of those terms".[18]

   Though this is correct, it is submitted that the ordinary and natural sense of terms which are explicitly defined in a statute should not take priority over those definitions, particularly in the case of a highly technical piece of legislation like the Credit Contracts Act.

2. The "natural meaning" of section 3(1)(a), which gives one definition of "credit contract", is that "the provision of money or money's worth is a provision to the person who makes the promise to pay rather than to some third party".[19]

   With respect, the wording of section 3(1)(a) is, on a literal reading, sufficiently wide to encompass contracts in which the credit is provided to a person other than the person promising to "repay" it. On this literal reading of section 3(1)(a) a contract of guarantee could be said to fall within the definition of "credit contract" in section 3(1)(a). However, this is only the first obstacle. The second obstacle is that the guarantor must also come within the Act's definition

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18 Supra n.17, at p. 17
19 Supra n.17, at p. 17

of a "debtor". In general it will be unlikely that a guarantor will be a person to whom credit is, or is to be provided under the credit contract, so as to be able to fall within the Act's definition of "debtor".

3. Under s.3(1)(a), the promise by "another person" to pay must be "in respect of the provision" of money or money's worth. However, his Honour stated that "the promise to pay of a guarantor is not so much in respect of the provision of money or money's worth to the principal debtor, as in respect of the default of the principal debtor".[20]

This is a somewhat technical argument, which sits oddly alongside the "ordinary and natural sense of [those] words" type of argument raised in relation to the first head of argument, but is strictly correct. Under an ordinary guarantee (i.e. a guarantee in which the guarantor is not deemed to also be a principal debtor) a guarantor is, strictly, liable not as a debtor but in damages for breach of their guarantee that the debt would be paid when due. By contrast, under guarantees in which guarantors are also deemed to be principal debtors, guarantors agree to pay the debt if and when called upon by the creditor to do so (and regardless of whether the person to whom the funds have been provided has had demand for repayment made upon them and failed to do so), and are therefore primarily liable in an action for debt and not (at least initially) for damages under an action in contract for breach of guarantee. However, this distinction should be irrelevant under the Credit Contracts Act, because the Act provides definitions of "debtor", "guarantor" and "credit contract".

Furthermore, in signalling this distinction, Wylie J. anticipated a line of authority which would later result

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20 Supra n.17, at pp 17 and 18

in two judges finding that disclosure must be made to guarantors who are also deemed to be principal debtors under these guarantee contracts.

It is submitted that this approach is misconceived in the context of whether disclosure is required to be made to a guarantor, which should be determined solely by reference to whether the contract of guarantee, alone, or together with other documents, is properly described as a (controlled) credit contract and, if so, whether the guarantor/principal debtor also falls within the definition of "debtor" contained in the Act, i.e. is a person who is, or is to be, provided with credit pursuant to the (controlled credit) contract.

4. Disclosure under section 16 is only required to be made to every "debtor", and the definition of "debtor" in section 2 "on its face does not include a guarantor".

   As discussed above, it is submitted that this is a correct analysis.

5. "Guarantor" is defined in section 2 in such a way that "a clear distinction is made between a debtor and a guarantor".

   Again, it is submitted that this is a correct analysis of the Act.

While it is submitted that Wylie J. arrived at the correct answer - i.e. that initial disclosure need not be made under section 16 to a guarantor who does not fall within the Act's definition of a "debtor", - that part of his Honour's reasoning which deals with whether a guarantee is a credit contract, and the distinction between those guarantees which also deem the guarantor to be a principal debtor, and those which do not, is, with respect, either incorrect or strictly irrelevant.

In Jenkins v. NZI Finance Limited[21] Tompkins J. found that not only was the mortgage, in respect of which the guarantee concerned had been given, not a credit contract, but, furthermore, that guarantors were only entitled to disclosure under section 19 (request disclosure) and not entitled to initial disclosure pursuant to section 16.

Mr and Mrs Jenkins had executed a mortgage over their home property to secure the personal guarantee given by Mr Jenkins to the defendant (NZI Finance) in respect of commercial loan facilities provided to several of Mr Jenkins' companies. When the companies proved unable to meet the payments required under the facilities, NZI Finance sought to enforce the mortgage over the Jenkins' home property by exercising the power of sale contained in the mortgage. The Jenkins sought an injunction against NZI Finance to prevent the power of sale being exercised. One of the grounds put forward by the Jenkins in support of the injunction was that the mortgage over the home property was a controlled credit contract, within section 15 of the Credit Contracts Act 1981, and that NZI Finance had not made the disclosure documents required by section 21 in respect of initial disclosure under section 16 available to Mr and Mrs Jenkins.

After deciding that the mortgage was not a controlled credit contract, because the exception contained in section 15(1)(f) of the Act applied, his Honour went on to state[22]:

> There is another reason why the initial disclosure provisions in s.16 do not apply to the mortgage. That section requires initial disclosure to be made to every debtor. The March facility evidenced a credit contract. As defined in s.2, "debtor" in relation to a credit contract, means a person to whom credit is, or is to be provided, pursuant to the contract. That person was M B Jenkins Limited. The mortgage itself was

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21 Supra n.13

22 Supra n.13, at pp 43-45

> not a credit contract. It was, as the March facility makes clear, a charge to secure the personal covenant of Mr Jenkins. So the mortgagors under the mortgage were not debtors as defined in s.2. [and were therefore not entitled to disclosure]
>
> Section 2 defines "guarantor" in relation to a credit contract, as meaning a person who guarantees the performance of a debtor's obligations under the contract, or who indemnifies a creditor against any loss which he may incur in respect of that contract, or who assumes liability for performing the obligations of a debtor under the contract.
>
> Clearly, Mr Jenkins was a guarantor. He guaranteed the performance of M B Jenkins Limited, under the credit contract evidenced by the March facility.
>
> .... A guarantor is entitled to request disclosure, pursuant to s.19. But a guarantor is not entitled to initial disclosure pursuant to s.16. There is no suggestion that any obligation for request disclosure has been breached. There has been no request. For this reason also, I am satisfied that NZI was under no obligation to make initial disclosure [to the mortgagor] either at the time of the March facility, or at the time of the execution of the mortgage on 8 May 1986. (Emphasis added)

It is submitted that Tompkins J has confused the two issues of:

1. whether the mortgage was a (or part of a) credit contract, and

2. if the mortgage was a (or part of a) credit contract, whether the mortgagor was properly described as a "debtor" or a "guarantor".

In Jenkins it appears that a strong case could be advanced for finding that the mortgage and the guarantee formed part of a credit contract, by virtue of sections 3(1)(b) and 4(1)(b)(ii) (and in relation to section 4(1)(b)(ii), on the assumption that the commercial loan facility documents contained the usual "further assurances" clause, whereby the borrower agrees to execute or procure the execution of such further or other documents as the lender requires to better secure the loan advances made to the company). However, even if this was the case, it seems clear that Mr and Mrs Jenkins would not have been "debtors" and thus eligible for disclosure, because the funds were not advanced to them but to the company M.B. Jenkins Limited.

The forensic waters were further muddied that same year by Gault J. in Elia v. Commercial and Mortgage Nominees Ltd and Others[23]. In Elia the Court was again required to consider the meaning of the term "credit contract". The plaintiff, in consideration of a loan being made by the defendant to a third party pursuant to a debenture, executed a guarantee in favour of the defendant, together with a mortgage over his home property as security for that guarantee.

The plaintiff contended that the mortgage was, by reason of its terms, "oppressive" within the meaning of s.9 of the Act. To obtain the required jurisdiction the Court first had to determine whether the mortgage was a credit contract.

The defendant's counsel argued that the nature of the mortgage should be determined by considering its substance other than its form and so should be seen as being simply a mortgage providing security for the guarantee, and therefore, on the basis of Wylie J's finding in Lloyd[24] that a guarantee does not constitute a "credit contract", (and also, presumably

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23 (1988) 2 NZBLC 103 296

24 Supra n.17

supported by Tompkins J's finding in Jenkins that the mortgage was a security document only and therefore not a credit contract) the mortgage would not be a "credit contract" within the meaning of the Act.

Referring to the reasons against disclosure advanced in Lloyd, his Honour concluded that the arguments were of a purely technical nature, and flew in the face of the express terms of the documents that he was considering. In particular, the debenture (which contained the guarantee clause) deemed Mr Elia to be a "principal debtor". Gault J. therefore distinguished the case before him from Lloyd on the grounds that Wylie J. did not appear to have had in contemplation a guarantee covenant that went further than a strict guarantee and also imposed the obligation of principal debtor on the covenantor.

Thus the distinction apparently drawn by Wylie J. in Lloyd, but not relied upon by him as a rationale for requiring disclosure, was used by Gault J to require disclosure of a controlled credit contract to a guarantor deemed by the guarantee contract to be also a principal debtor.

It is worth noting that the guarantor was the first defendant in Lloyd, the original debtor the second defendant. While it is not clear from the text of the judgment, therefore, it is quite possible that the guarantee document at issue in Lloyd did contain a clause deeming the guarantor to be a principal debtor.

Gault J. suggested two alternative routes whereby the debenture (containing the guarantee clause) and the mortgage over the house property, which was given to secure the guarantee obligations contained in the debenture, could together constitute a credit contract.

Both section 3(4) and section 4(1)(b) provide, in different ways, for a series of documents together to constitute a credit contract.

Gault J felt that Wylie J's comments in Lloyd were confinable to a simple guarantee and were not to be extended to the form of covenant that goes further and imposes the obligations of principal debtor upon the covenantor. His Honour concluded that the plaintiff was a principal debtor under both the debenture and the mortgage, and on their face, both documents clearly fell within the definition of "credit contract" in s.3 of the Act.

While this conclusion is susceptible to several differing interpretations, it is submitted that it would not have been appropriate to find that the debenture and mortgage each formed a separate contract. His Honour appeared to recognise this by stating that this was a situation that came within s.3(4) of the Act, which provides that where by virtue of any arrangement there is a transaction that is in substance or effect a credit contract, the arrangements shall, for the purpose of the Act, be deemed to be a credit contract.

Section 3(4) provides that:

> [w]here, by virtue of any contract or contracts (none of which by itself constitutes a credit contract) or any arrangement, there is a transaction that is in substance or effect a credit contract, the contract, contracts, or arrangement shall for the purposes of this Act be deemed to be a credit contract.....

It is submitted that this reasoning is questionable in this case. The debenture itself could clearly alone constitute a credit contract, and so s.3(4) could not be relied upon. Where there are written contracts then it would not appear to be open to the Court to rely on the alternative route to finding the existence of "substance or effect" credit contract by finding

that there was an arrangement. It is submitted that the two routes are mutually exclusive, as evidenced by the disjunctive "or" in the section.

His Honour also concluded that he was satisfied that it was a term of the overall arrangement that the mortgage be entered into, so that the mortgage and the debenture together formed the credit contract by virtue of s.4(1)(b) of the Act. It is submitted that this part of His Honour's analysis is, however, correct.

Section 4(1)(b) provides:

> Where it is a term of a credit contract that another contract or a deed be entered into, the following provisions shall apply:
>
> (a) ....
>
> (b) If the other contract or deed is to be entered into for the purposes of giving security for the credit provided under the credit contract -
>
> (i) The whole of that other contract or deed shall be deemed to form part of the credit contract for the purposes of this Act (whether or not it is entered into at the same time as the credit contract is made); and
>
> (ii) For the purposes of Part II of this Act, the credit contract shall be deemed to be made when the other contract or deed is made or the credit is provided pursuant to the credit contract (whichever is the earlier).

Also, his Honour's view was that section 3(1)(a), (b) and (c) should not be read as limited to situations in which the loan or forbearance is necessarily made to the person providing

the promise by way of consideration (that is, contrary to the interpretation favoured by Wylie J. in Lloyd). His Honour stated that section 3(1)(a), (b) and (c) seem to have been drawn specifically to avoid any necessary identity between the person to whom the loan or promise of forbearance is given and the person making the promise to repay or procure the repayment.

While such a construction is considered to be correct, arguably s.3(1) can never include stand-alone guarantees in themselves. A stand-alone guarantee, it could be argued, will only form part of a credit contract if an all-encompassing definition of the term "credit contract" is adopted, thus allowing all loan and security documentation executed in connection with the provision of money or money's worth to be regarded collectively as the credit contract, or by virtue of s.4(1), or, possibly, s.3(4).

This aspect was recognised by Williamson J in Westpac Banking Corporation v Morris[25] where counsel argued that a stand alone guarantee could not come within the provisions of s.3 of the Act. His Honour noted:

> "Certainly the indication in these documents is that the guarantee was being given in relation to the affairs of the customer company and the probabilities are that other re-arrangements, advances or agreement to continue advances or not to pursue remedies were being discussed or implemented at the same time. It is most unlikely that the Defendant was merely attending at the Bank's premises in order to sign the guarantee without such guarantee being part of other transactions or agreements."

An alternative argument is that a stand-alone guarantee (whether of the "simple" guarantee kind or the type of guarantee where the guarantor is also deemed to be a

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25 Unreported. CP 269/87, Dunedin Registry, 28.4.87

principal debtor) could fall within the literal words of the section 3(1)(b) definition, even though, at least in the case of a "simple" guarantee, the promise to pay or procure payment is efffectively based on a contingency, i.e. that the person to whom the credit is extended is unable or unwilling to repay after demand has been made on him or her, and the "simple" guarantor's liability is secondary to the debtor's primary liability. There is nothing in the section which precludes reliance on such a contingency. Indeed, section 3(2) specifically provides that the term "promise", as used in section 3(1), includes a conditional promise.

It is submitted that this is the better view, and that therefore, in many cases, a stand-alone guarantee may be classified as a credit contract under section 3(1)(b), even though the person making the promise to repay will, invariably be a "guarantor" (as defined in section 2), and not a "debtor", (as defined in section 2) and not therefore someone to whom disclosure under sections 16, 17 or 18 has to be made.

Even though the interpretation placed on section 3(1) by Gault J. is to be preferred to that of Wylie J in Lloyd, the fact that a guarantee may be, or form part of, a credit contract does not mean that the Act automatically requires disclosure to be made to a guarantor, when that guarantor is deemed by the terms of the particular contract to be a "principal debtor". It is not sufficient to claim merely that arguments to the contrary are "of a technical nature" and "fly in the face of express terms of the documents". Disclosure under sections 16, 17 and 18 is only required to be made to persons who fall within the Act's definition of "debtor". It is not sufficient to require disclosure that a guarantee (or other document) deems the guarantor to be a principal debtor, if that person cannot be interpreted to fall within the statutory definition of "debtor".

This was specifically recognised by Thorpe J. in Stewart and Another v. Westpac Banking Corporation Limited[26]. His Honour expressly agreed with the conclusions reached by Wylie J. in Lloyd and by Tompkins J. in Jenkins that the Act's distinction between debtors and guarantors proceeds on the basis, apparent particularly from the definitions of those terms in section 2, that debtors are persons "to whom credit is or is to be provided" and accordingly that guarantors are not persons to whom disclosure is required by section 16(2).

Disagreeing with the views expressed by Gault J. in Elia, Thorpe J. concluded that the common provision in guarantees that a guarantor shall for the purposes of the contract be deemed to be a principal debtor, did not automatically convert that guarantor into a "debtor" for the purposes of the Credit Contracts Act.

The judicial debate over disclosure has continued with the most recent case to consider this question - Feltex Modular Carpets Pty Limited v. Day.[27]

To ensure continuing supplies from Feltex to their company Star Flooring Limited, Mr and Mrs Day entered into a deed under which they guaranteed the due and punctual payment of all monies currently owing and owed in the future by Star Flooring to Feltex in accordance with an annexed payment schedule. Under this deed of guarantee, Mr and Mrs Day were deemed to be principal debtors viz a viz Feltex, as creditor. The schedule showed the amount of debt due and added bank fees on a dishonour and interest on the reducing balance at 20%. No disclosure was made by Feltex in respect of the deed.

In response to Mr and Mrs Day's claim, in defence to Feltex's claim for summary judgment against them under the guarantee, that the deed was unenforceable by virtue of non

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26 Unreported. CP 1883/90, Auckland Registry, 24.7.91

27 Supra n.16

disclosure, Feltex argued that the original contracts for supply together with the guarantee did not come within the definition of "credit contract". This, however, was rejected by Master Williams on the grounds that the guarantee was a contract under which Feltex agreed to forebear from requiring payment of the money due to it in consideration of the promise by Mr and Mrs Day to pay or procure the payment in the future and in respect of the forbearance a sum of money which exceeded the amount of the original debt by the addition of bank fees and interest. The arrangement was thus considered by his Honour to be clearly a credit contract under section 3(1)(b).

Master Williams held that it was tolerably plain that true guarantees - as opposed to documents making persons signing them principal debtors - did not clearly come within the definition of a credit contract. His Honour concluded that guarantees are clearly not within section 3(1)(a). Their relationship to section 3(1)(b) however, was regarded by him as being a little more obscure, because the phrase "another person" might be capable of extending to a guarantor. However, his Honour was of the view that if the legislature intended this, it could have provided so explicitly, particularly since "guarantor" is defined in section 2 and a clear distinction is drawn between debtors and guarantors in the disclosure provisions in section 16 to 19.

Despite this explicit recognition of the distinction between debtors and guarantors, however, Master Williams went on to conclude that disclosure was required to be made to guarantors who were principal debtors. After quoting extensively from both Lloyd and Jenkins, as well as referring to Stewart, Master Williams quoted extensively from Elia, in particular the passage in which Gault J. distinguished Lloyd on the grounds that the guarantor in Lloyd was not a principal debtor.

In applying these decisions (concerning which he remarked that there currently appeared to be a difference of judicial view), Master Williams suggested that one point of possible distinction between those cases and the one before him was that unlike the case before him the earlier decisions all appeared to have dealt with guarantees executed contemporaneously with the initial provision of credit and with guarantees which formed part of the initial security documents, thus leading to a consideration of the effect of section 3(4). In fact, only Elia considered the effect of section 3(4).

It appears, however, that his Honour's concern was to distinguish cases in which guarantees had been held not to form (part of) credit contracts from the case before him on the grounds that Feltex's forbearance, in consideration of the giving of the guarantee, clearly brought the guarantee within section 3(1)(b).

His Honour stated:[28]

> In the circumstances of this matter, the first question is whether the document of November 1989 [i.e. the deed of guarantee with annexed repayment Schedule] comes within the definition of a "credit contract".
>
> It was clearly a new contract entered into between Feltex and Mr and Mrs Day under which they agreed both to pay the amount of Star Flooring's debt and to pay interest and bank fees already charged by Feltex to Star Floorings and future interest on the diminishing balance. It was expressed to be made in consideration of Feltex's supply of goods to Star Floorings and its forbearance from suing that company. It is therefore a contract under which Feltex agreed to forbear from requiring payment of the money due to it by Star Floorings in consideration of

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28 Supra n.27, at 102, 653

> the promise by Mr and Mrs Day to pay or procure the payment in the future and in respect of the forbearance a sum of money which exceeded the amount of the original debt by the addition of bank fees and interest up to November 1989 and interest thereafter. That, in this Court's view, brings the November 1989 contract squarely within the definition of a "credit contract" in s.3(1) and, in addition, the arrangement is in substance a credit contract and thus also falls within s.3(4).

And further:[29]

> When those authorities [i.e. Lloyd, Jenkins, Elia] are applied to the facts of this case to consider whether the November 1989 document comes within the definition of "credit contract" it is to be borne in mind that one point of possible distinction between the cases earlier discussed and this case is that they all appear to have dealt with guarantees executed contemporaneously with the initial provision of credit and with guarantees which formed part of the initial security documents, thus leading to a consideration of the effect of s.3(4) as well as s.3(1)(a)(b).
>
> Such is not the case here. This case is concerned with a contract pursuant to which Mr and Mrs Day each undertook a new and direct personal liability to Feltex for the existing debt owed to Feltex by Star Floorings plus payment of the interest for which the November 1989 agreement provided, their assumption of that liability being expressed to be in consideration for Feltex's forbearance from suing Star Floorings. In this Court's view, seen in that light, the November 1989 document comes within the definition of "credit contract" in s.3(1)(b).

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29 Supra n.27, at 102, 655

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> In addition, the November 1989 document imposes an obligation for interest and bank fees on Mr and Mrs Day in addition to the debt then owed to Feltex by Star Floorings. Arguably, therefore, the November 1989 contract is "in substance or effect a credit contract" and is therefore deemed to be a "credit contract" pursuant to s.3(4).

However, as has been discussed above, whether a guarantee forms (part of) a credit contract is, for the purposes of disclosure, only the first part of the issue. For disclosure to be required there must first be a controlled credit contract. Such disclosure only has to be made to every "debtor" (as defined in the Act) for the time being under that controlled credit contract.

Having found that the deed of guarantee was a credit contract under section 3(1)(b), and, together with the original sales dockets, also part of an arrangement which constituted a credit contract pursuant to section 3(4), Master Williams then proceeded to consider whether the 20% interest rate was "a reasonable amount payable upon default" within the terms of section 3(3)(b)(ii), which would have the effect of taking the arrangement out of the definition of "credit contract". As no evidence as to the reasonableness or otherwise had been presented to the Court, Master Williams felt unable to conclude that the bank fees and interest provisions fell within this exclusion. The contract was thus a credit contract because the 20% interest was properly classified as a charge for credit rather than liquidated damages for default.

The final question was whether the credit contract was a "controlled credit contract" under section 15(1)(a). This depended upon "whether or not Feltex came within the definition of "financier" in that section. As this was "a matter entirely within [Feltex's] knowledge", and Feltex had chosen not to exercise its right of reply in this matter, Master Willliams concluded that Feltex had failed to satisfy the

Court that it was not a financier and that the guarantee was not a controlled credit contract.

Master Williams therefore concluded that there was an obligation on Feltex to give initial disclosure to Mr and Mrs Day in accordance with sections 16, 20 and the Second Schedule to the Act. That is, the guarantee was (part of) a controlled credit contract, and controlled credit contracts require disclosure. As this disclosure had not been given, Feltex was unable to enforce the guarantee and its application for summary judgment was therefore dismissed.

It is submitted that this result is incorrect. Whether or not a guarantee is (part of) a controlled credit contract is a separate (and preliminary) question from whether disclosure is required to be made to guarantors. The Act is clear in distinguishing debtors and guarantors and requiring disclosure only to the former. Though Mr and Mrs Day clearly undertook a direct and primary obligation under the guarantee document to repay the advances made to Star Flooring, the mere assumption of this primary liability could not convert them into "debtors", as defined in section 2, i.e. persons to whom credit is, or is to be provided. The credit was provided to Star Flooring alone.

If, however, the original rights of Star Flooring as debtor had been assigned to Mr and Mrs Day, with Feltex's consent, by Star Flooring, or the loan facility to Star Flooring had been novated so that Mr and Mrs Day stepped into the shoes of Star Flooring, then clearly Mr and Mrs Day would have been "debtors" under the section 2 definition, and therefore entitled to disclosure. They would have been persons to whom credit was provided. However, it is clear from the guarantee document that there was no assignment of Star Flooring's rights and obligations as debtor or any novation whereby Mr and Mrs Day undertook for the future, the rights and obligations of Star Flooring. Though the guarantee document deemed Mr and Mrs Day to be principal debtors

viz a viz Feltex, Star Flooring, and Star Flooring alone, was the legal entity to which credit was provided.

Conclusions

It is submitted that the results reached by Wylie J in Lloyd[30] and Tomkins J in Jenkins[31] are to be preferred to those reached by Gault J in Elia,[32] and Master Williams in Feltex.[33] Whilst in Elia and Feltex the mortgage and guarantee documents, respectively, may well have referred to the plaintiff being liable as a "principal debtor", it does not automatically follow that the plaintiff was a "debtor" in terms of the Act - he was not the person to whom credit was provided. Disclosure is only required to a debtor - and that definition is determined by s.2 and not solely by reference to the wording used in the contract between the lender and the guarantor.

Care needs to be taken to properly determine what documents constitute "the credit contract", and the nature of the rights and obligations undertaken by the various parties to those documents before a decision can be made to whom disclosure is required. This decision is, in the final event, a determination which must be made strictly in accordance with the terms of the Credit Contracts Act.

As has been demonstrated above, it is not enough that a guarantee document which on its own, or together with other documents, is a credit contract deems the guarantor to be a principal debtor viz a viz the creditor. For disclosure to be required the "principal debtor" must, on a proper construction of the document or documents forming the controlled credit contract, and a proper analysis of the transaction or transactions which they describe, be able to be described as

30 Supra n.17
31 Supra n.21
32 Supra n.23
33 Supra n.16

"a person to whom credit is, or is to be, provided" pursuant to the credit contract in question.

It is submitted that in none of the cases analysed above could the guarantors be aptly so described, such as to justify a conclusion that they were "debtors" in terms of the Act and therefore persons to whom disclosure should have been made.

From a creditor's perspective, given the confused state of the law and the current lack of any Court of Appeal judgment on the issue, it is highly advisable for disclosure to be made by creditors to all guarantors who are deemed to be "principal debtors" in respect of guarantees which alone, or together with other financial arrangements, are likely to constitute "controlled credit contracts" under the Act.

From a guarantor's perspective, the currently unsettled state of the law will be advantageous where the guarantor is deemed by the contract of guarantee to be a principal debtor and where disclosure has not been made. If, for any reason, a guarantor wished to ensure that disclosure was made under the Act, whether or not they were deemed to be principal debtors, they could attempt to negotiate a clause to be included in the contract of guarantee deeming them to be a debtor under a controlled credit contract, for the purposes of the Credit Contracts Act 1981 and thus eligible for disclosure. However, given the realities of the credit market place, it is suggested that rarely, if ever, will a prospective debtor be able to negotiate successfully on this issue.

While this technique could not convert a guarantor into a debtor, in terms of the definition in the Credit Contracts Act, if he or she would not otherwise meet the definition, there would at least be a contractually enforceable right to the same level of disclosure as a "debtor" under the Act and would also expose a creditor, who fails to disclose, to the

same sanctions for non-disclosure as would apply under the Act.

By this technique a guarantor could obtain the same protection, by contract, as a "debtor" would enjoy by statute.

Should guarantors be equated with debtors for the purposes of the disclosure requirements of the Act?

A compelling case can be made for requiring disclosure under the Act to debtors and guarantors in the same circumstances. While the "credit-shopping" rationale does not, by its terms, apply to guarantors, a guarantor is critically interested in knowing exactly what obligations he or she is guaranteeing. A guarantor must be able to accurately assess the ability of the debtor that they are guaranteeing to meet their obligations to repay that debt and the associated credit changes. An extension of the disclosure regime to guarantors would ensure that accurate information on the repayment obligations of debtors was supplied to guarantors so that they could assess the commercial risk (in commercial situations) of guaranteeing the debt. Clearly, in family-type transactions, where guarantors will be prepared to act through "natural love and affection", or a feeling of moral obligation, this rationale will not apply with the same force, but it is submitted that this does not derogate from the force of the argument in favour of extending the benefits of disclosure to guarantors.

This submission is reinforced by the fact that the penalties for failure to disclose which are contained in sections 25 to 30 of the Act are available for the benefit of both debtors and guarantors, surely a legislative recognition that the consequences of a failure by a creditor to fulfil its disclosure obligations are of equal significance to both debtors and guarantors.

Recommendations

(1) It is recommended that the obligations imposed on creditors to disclose to debtors by virtue of sections 16 and 17 of the Act be extended to guarantors by the addition of a reference to every "debtor and guarantor" in sections 16(2) and 17(2), and also by redrafting sections 16(2) and 17(2) to refer to the necessity to disclose to every debtor and guarantor under or in relation to the controlled credit contract. The addition of the words "or in relation to" should be sufficient to avoid the technical arguments and logical gymnastics encountered in the cases analysed above about whether guarantees can be brought within the definition of "credit contract" by recourse to section 3(1), 3(4), 4(1), or a combination of these provisions. The addition of the words "in relation to" would make it clear that disclosure is required to a guarantor, whether or not the guarantee is, technically, part of a controlled credit contract. The redrafted sections 16(2) and 17(2) would thus read:

> 16(2) In this Act the term "initial disclosure", in relation to a controlled credit contract, means disclosure of the contract to every debtor and guarantor for the time being under or in relation to the contract in accordance with section 20 of this Act.

> 17(2) In this Act the term "modification disclosure", in relation to a modification contract, means disclosure of the modification contract to every debtor and guarantor for the time being under or in relation to the controlled credit contract to which the modification contract relates, in accordance with section 20 of this Act.

(2) In relation to section 18 disclosure (continuing disclosure of revolving credit contract) it is recommended that guarantors continue to have the choice of requesting regular periodic disclosures (under section 19), but that continuing disclosure under section 18 not be made mandatory in respect of guarantors. The rationale for treating section 18 disclosures differently from section 16 and 17 disclosures is that by far the bulk of controlled credit contracts covered by section 18 will be credit card contracts. Rather than automatically put a creditor to the expense of routinely sending out duplicate statements it is recommended that a guarantor should be left to rely on his or her rights to disclosure under section 19 (disclosure on request).

(3) A related point is that the information specified in Part IV of the Second Schedule to the Act, which is the information that a debtor or guarantor may request to be disclosed by virtue of section 19(a), refers to a period of 6 months previous to the request for disclosure within which the information requested and disclosed must be current (Part IV clauses 1 (Outstanding amounts) and 2 (Finance rate under revolving credit contract)). Six months appears to be an unduly lenient period of time to extend to a creditor and it is recommended that, after consultation with banks and other major providers of "revolving" credit that, if appropriate, a period of 2 or 3 months should be substituted, or such lesser time as can reasonably be expected to be complied with.

(4) Given the requirement in relation to revolving credit contracts in section 18(2) that the "specified period" for supplying disclosure information in relation to a billing period of <u>3 months or less</u> is that disclosure is to be made within 20 working days, it would seem to be appropriate that request disclosure to guarantors of

revolving credit contracts should also be premised on a more realistic period, such as the 3 months benchmark adopted by section 18(2). The writer's own experience has not led him to the acquaintance of a species of revolving credit contract, in relation to sums under $250,000, where bills are submitted to the debtor at greater than 3 monthly intervals. If the writer's experience holds true then section 18 should be amended to delete the definition of "specified period" contained in section 18(2) and also to substitute a reference in section 18(1) to "20 working days" for the reference to the "specified period".

(5) Given the different approaches taken in the cases discussed above to the question of whether, pursuant to section 3(1), the person to whom, for example, money or money's worth is provided, must be the same person who promises to pay, or procure payment, in the future, of a greater sum, it is recommended that the current doubts be resolved by amending section 3 to reflect the approach to this issue taken in Elia and Feltex that, the "debtor", as defined in section 2, does not, for the purposes of section 3(1)(a)-(e), have to be the same person who also promises to pay, or procure the payment of, in the future a greater sum (or, in relation to the discounting transactions contemplated by section 3(1)(f), a lower sum).

Though this amendment will not be technically necessary to ensure that disclosure is made to every debtor and guarantor (if recommendation (1) above is implemented by inserting the "under or in relation to" amendment to sections 16(2) and 17(2)), it is submitted that the amendment is required to achieve consistency with the amendments recommended to section s16(2) and 17(2), and will also ensure that, in appropriate cases, mortgagors and guarantors will also

be able to take advantage directly of the reopening provisions contained in Part 1 of the Act without the necessity to navigate the complexities of sections 3(4) and 4(1).

(c) **Section 3(3)(b)(ii)**

Section 3(3)(b)(ii) provides that for the purposes of determining whether a contract is a credit contract within the meaning of section 3, any reasonable amount payable as a result of a default under the contract by the promisor is not to be included as part of the sum or sums of money promised to be paid in future. In effect then, the subsection seeks to distinguish between liquidated damages, which form a genuine pre-estimate of loss as a result of a default by the other party under a contract, and ordinary credit charges. It is only if the amounts charged can truly be categorised as credit charges that the contract will be a credit contract, as defined in the Act.

The section provides:

> For the purposes of determining whether a contract is a credit contract within the meaning of this section, -
> ....
> (b) The following amounts shall not be included as part of the sum or sums of money promised to be paid in the future:
> ....
> (ii) Any reasonable amount payable as a result of a default under the contract by the promisor.

This part of the paper will only deal with the "amount payable as a result of a default under the contract" limb of the sub-section. The question of the "reasonableness" of that amount will not be considered.

The most recent case to discuss this issue is Williams and Kettle Ltd v Duncan.[34]

Duncan entered into a contract with a stock and station agent. The contract, described as an "Application for Trading Account", provided Duncan with authority to buy goods on credit. The agreed period of credit varied depending on the type of goods purchased, but payment was usually due one month from the date of supply.

The contract provided that if full payment was not made by the due date, compound interest on the outstanding amount would be charged "at the rate from time to time determined by the Chief Executive of the company". The agreement contained detailed provisions relating to payment of interest, including the fact that the then applicable rate or rates of interest would be disclosed to Duncan on the monthly statement which he received. At the time of entering the contract Duncan was not offered the opportunity to gain independent legal advice. The agent also failed to disclose the rate of credit payable under the contract.

Duncan fell behind with a number of payments. The agent charged compound interest of 25%. Summary judgment was sought by the agent and entered by consent. Duncan objected to the interest being claimed as he alleged that the non-disclosure of the rate of credit under the contract was a breach of the Credit Contracts Act, thus prohibiting the agent from enforcing the interest provision.

The agent argued that the interest provision was still enforceable despite the non-disclosure because the contract was an exception under s.3(1)(i) or 3(3)(b)(ii) to the definition of "credit contract" in the Act.

In giving judgment in favour of Duncan, Master Williams held that:

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34 (1991) 3 NZBLC 102, 405

1. The contract was not one for the sale of property which merely provided for a penalty to be paid in the event of default. The contract gave the purchaser an option of paying cash when due or paying interest on the balance overdue. The contract was therefore not an exception to the Act under s.3(1)(i).

   (i) The contract stipulated that payment for the goods fell due in the month after supply. It also provided for what would happen if the purchaser failed to meet the due date. The parties to the contract did not originally contemplate the provision of prolonged credit. Swift payment of the whole was expected.

   (ii) Despite this, the substance of the contract was that Duncan had the option to pay for the goods in full on the due date or to pay more for the goods later. The description of the interest to be charged for late payment as liquidated damages did not bring the contract within the exception in s.3(3)(b)(ii). A court must be satisfied that the penalty charged for late payment under a contract is, in fact, a genuine statement as to liquidated damages which would be imposed for default.

2. In the present circumstances the Court felt constrained by previous authorities to hold that the contract was not within the exception set out in s.3(3)(b)(ii).

3. The contract was a controlled credit contract for which inadequate disclosure was made, and attracted the operation of sec.24 and 25 of the Act.

4. Had previous authorities not been so firmly against a finding that the contract fell within the exception in

> s.3(3)(b)(ii), the Court would have been willing to accept that the interest charged by the agent was, in this instance, a genuine pre-estimate of its damage. The amount charged was reasonable in light of the agent's circumstances and was also in line with the amount charged by its competitors. It was therefore not unreasonable and the agent may also have been entitled to relief under sec 31 and 32 of the Act.

His Honour decided that the contract was a controlled credit contract because, in his view, Williams and Kettle was a financier by virtue of paragraph (b), of the definition of "financier" (which provides that a financier includes any person who makes a practice of providing credit in the course of his business), and also by virtue of section (3)(1)(a):[35]

> There can be little doubt that the trading account application is a contract for the provision of money, namely for "initial purchase of stock then merchandise", in consideration of Mr and Mrs Duncan's promise to pay for that stock and sums exceeding the cost of that stock by virtue of the provisions as to interest previously set out.
>
> It is also clear from the terms of the Long Title to the Act and the other provisions of the statute that it was intended by the legislature that the Credit Contracts Act 1981 should be all-embracing unless persons contracting came clearly within the exceptions to the Statute.

Given the nature of the agreement it would seem to have been more appropriate to describe the agreement as a contract for the provision of "money's worth" (i.e. purchase of stock, then merchandise), rather than money, under section 3(1)(a).

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35 Supra n.34 at 102, 409

Having found that there was a controlled credit contract which, prima facie, required disclosure under the Act, His Honour then turned to consider[36] whether the imposition of liquidated damages by way of interest should be excluded in considering whether the agreement was a "credit contract" by virtue of the provisions of s.3(3)(b)(ii), i.e. whether it is a "reasonable amount payable as a result of the default under the contract":

> The first aspect of s.3(3)(b)(ii) on which the Court's consideration requires to be focused is the phrase "default under the contract" and immediately it is to be noted that there is a difference of view expressed by the various Judges in the cases referred to, doubtless arising out of the different factual situations with which each was dealing. Gallen J in Mead, Vautier J in Italia Holdings, Holland J in Patrikios and Barker J in Turners Horticultural Supplies, all took the view that in the circumstances of their cases agreements to pay interest were not amounts payable as a result of a default .... while Williamson J in McHaffie was concerned principally with the reasonableness of the amount charged although he did hold (at p. 101, 850) that the difference between Meade and McHaffie was that in the latter "there were no further discussions between the parties relating to interest" such as occurred in Mead.
>
> The contract between these parties makes it clear that payment for goods purchased falls due on the 20th of the month following supply and payment for livestock falls due on the 14th day following purchase (despite the contract also being sufficiently commercially realistic to provide for what happens in the event that the purchaser breaches the contract by failing to meet in full the debts owing on due date). Additionally, in

36 Supra n.34 at 102, 415-416

> this particular case, it is clear from the factual circumstances reviewed in the judgment of 23 April and the findings made by the Court on that occasion that the parties to this transaction did not originally contemplate the provision by Williams & Kettle of prolonged credit. Swift payment of the whole of the debt was expected.
>
> In those circumstances, were it not for the preponderance of the authorities previously discussed, this Court might have been inclined to hold that Mr and Mrs Duncan have been in "default under the contract" for over a year but, despite Mr Dugdale's comment earlier cited, the main authorities where the question has been argued and which, factually, bear the closest resemblance to the facts of this matter indicate that such is not the case. The substance of the contract between Williams & Kettle and the Duncans was that the Duncans had the option of paying for the goods and livestock in full on due date or of paying more for the goods in consequence, that additional payment being by way of interest calculated in accordance with the contract even though the interest is described as liquidated damages. On the basis of those authorities, this Court feels constrained to hold that Williams & Kettle is not entitled to the exception set out in sec.3(3)(b)(ii). That view is fortified by the Long Title to the Act, the clear legislative intention that all contracts pursuant to which persons are required to repay more than the amount lent or the costs of the goods bought should come within the ambit of the Act, unless clearly excepted therefrom, and the provisions of sec.3(4). (Emphasis added)

The reference to Dugdale[37] is a reference to that author's commentary on section 3(3)(b)(ii):

37 Supra n.8

> If the contract is expressed as one where interest is payable in default of prompt payment, then provided the amount is reasonable the transaction is outside the definition.
>
> This seems to offer a loophole; but the test of substantiality provided for in subsection (4) should not be overlooked.

It is evident from the above discussion that Master Williams felt constrained by the earlier authorities which have dealt with this issue to find that section 3(3)(b)(ii) had no application. In the absence of such a supposed preponderance of authority it is clear that the Master would have found that section 3(3)(b)(ii) applied, even though the Duncans had been "in default" under the agreement for over a year, and, during that period had never received adequate disclosure in terms of the Act.

In these circumstances it is necessary to consider the essential elements of the earlier decisions relied upon by Master Williams in order to determine whether, in truth, they ineluctably lead to the conclusions which Master Williams so reluctantly adopted.

The earliest case to deal with section 3(3)(b)(ii) is Wrightson NMA Limited v Mead.[38] In that case the defendants, Mr and Mrs Mead, were farmers who had recently purchased a farm and who sought to purchase a herd of cows through the plaintiff (Wrightsons). In due course a suitable herd was located and the Meads agreed to buy it. They signed a sale note which required them to make payment of the balance of the purchase price within 14 days. The Meads were unable to find the required amount on the due date and advised Wrightsons of this. Wrightsons advised that payment of interest would be required in addition to the balance of the

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[38] (1984) 1 NZBLC 102, 093

purchase price. The issue in this case was whether Wrightsons were entitled to payment of interest.

The Meads submitted that they were not liable for payment of interest as either a revolving credit contract or a controlled credit contract existed within the meaning of the Credit Contracts Act and that Wrightsons had failed to comply with the provisions of that Act.

Wrightsons argued, inter alia, that the exception contained in section 3(3)(b)(ii) applied.

After finding that there was a controlled credit contract and that, in the absence of any exception, proper disclosure should have been made, his Honour considered[39] the applicability of section 3(3)(b)(ii):

The second submission related to the situation which arose on 16 June 1982. The defendant said in evidence that because of the deferment in the dairy company payments, he knew he would not be in a position to pay for the stock on 16 June and he accordingly went to see a Mr Peter Lewis of the plaintiff company on that date. The defendant said that Mr Lewis informed him that the plaintiff company would make its payout some time before October. The defendant says that the interest rate was not discussed, but that Mr Lewis informed him that the plaintiff company would just charge the ordinary interest rate [as against the higher penalty rate] through until payment was made. Mr Lewis was not called and effectively the evidence of the defendant is the only material before me relating to this transaction. The defendant says that the arrangement was a controlled credit contract within the meaning of s.15 of the Credit Contracts Act. There is no doubt that the arrangement came within the definition of "credit contract" and since the plaintiff is a financier, I think the arrangement was a controlled credit

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39 Supra n.38 at 102, 097

contract for the purposes of s.15 of the Credit Contracts Act 1981 unless it came within one of the exceptions.

And further:[40]

> That provision [i.e. section 3(3)(b)(ii)] is, in my view, designed to cover figures included in contracts as liquidated damages. I do not consider that it covers this case, for if it did there would be a loophole in the Act so wide that its provisions could be avoided by a simple conveyancing device. In this case, what the parties talked about was interest on an amount loaned, which is precisely what the Act is designed to cover.
>
> ....in my view a precise and definite agreement was entered into when the defendants' shortfall was known at the time of settlement.

The next case which dealt with the issue is <u>Patrikios Holdings Limited</u> v <u>United Fisheries Limited</u>.[41]

Patrikios was a fish retailer. It bought fish from United, a fish wholesaler, by auction and otherwise. Patrikios also sold fish, and, in so doing, extended credit to certain of its customers.

There was no written contract between the parties as to terms of trade. Sales to Patrikios by auction were made on the basis of payment in full within seven days. United required payment of other purchases by Patrikios to be made within seven days of date of statement, although a considerable sum was invariably owed by Patrikios for outstanding purchases.

The parties operated a current account. Patrikios owed United moneys, about two-thirds of which was more than three months overdue. Any payments made from time to

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40 Supra n.38 at 102, 097

41 (1986) 1NZBLC 102, 423

time were applied in reduction of the current account. Patrikios made no directions to United as to appropriation of the funds paid. Concerned for its liquidity, United wrote to Patrikios ("the credit letter") requiring Patrikios to adhere to weekly payment terms for all future purchases. The credit letter also stated a charge would be added to weekly accounts on any overdue balance ("the interest").

Patrikios received the credit letter and continued to trade with United. From then on, United sent weekly statements to Patrikios showing purchases made, the interest calculation, and any credits for payments received.

The parties continued to trade until 1 June 1984. Patrikios then paid a large part of its current account, and directed that this payment should be credited to purchases and not interest. It did not consider itself to owe any more to United. United prepared to wind up Patrikios to recover its debt. Patrikios responded by obtaining an injunction restraining the winding up, and making application to reopen the contract made between the parties.

By a counterclaim, United sought the balance of its current account, together with interest at the rate stipulated in the credit letter.

It was common ground between the parties that United was a financier under s.2(1) of the Credit Contracts Act 1981 and it had not made disclosure of the terms of the contract as required by the Act.

Holland J held, inter alia, that:

1. Patrikios had made purchases after receipt of the credit letter, and without settling its account within the seven-day period stipulated. It had therefore accepted the terms of the credit letter and these became part of

the contract between the parties. United was entitled to charge interest on the overdue accounts.

2. The transaction between the parties was a credit contract within terms of s.3(1)(d) of the Credit Contracts Act. United had an implied right to give reasonable notice to Patrikios calling up the current balance and interest, but this did not bring the transaction within s.3(1)(i) of the Act and prevent it from being a credit contract.

3. Each purchase by Patrikios following its receipt of the credit letter was a credit contract, because of the express or implied promise to pay interest on all such purchases not settled within the seven-day period.

4 The election by Patrikios to pay interest rather than cash did not constitute a default under s.3(3)(b)(ii) of the Credit Contracts Act.

Section 3(3)(b)(ii) was directed at a contractual provision for damages by way of penalty for default, rather than a provision giving a purchaser an option of paying cash or paying interest on an overdue balance.

His Honour stated:[42]

> I am satisfied that each time the plaintiff purchased fish from the defendant following the letter of 12 March 1980 it entered into a credit contract by virtue of the express or implied promise of the plaintiff to pay interest at 0.4% per week in respect of all purchases not settled within seven days of auction or statement. Section 3(3)(b) provides a number of amounts that are not to be included as part of the sum or sums of money promised to be paid in the future referred to in s.3(1)(d). Subparagraph (ii) of that

[42] Supra n.41 at 102, 429

> subsection is "any reasonable amount payable as a result of default under the contract by the promisor". I do not regard the agreement to pay interest in the circumstances of this case as being an amount payable as a result of default within the meaning of the subparagraph. It was contemplated by the parties that interest would be payable after seven days, and I do not regard the acceptance by the plantiff of the liability to pay interest rather than pay cash as being a "default". Like Gallen J in Wrightson NMA Ltd v Mead & Anor (1984) 1 NZBLC 102, 093, I regard the statutory provision as being designed to cover a provision in a contract for damages by way of penalty for default rather than as here a provision giving a purchaser an option of payment cash or paying interest on the balance overdue. (Emphasis added)

The final significant case requiring analysis is McHaffie v Pyne Gould Guiness Limited.[43] The facts of this case are that McHaffie (a farmer) purchased stock at an auction from Pyne Gould Guiness Ltd (the auctioneer). He took delivery of the stock but did not pay for it until almost two years later. The auction had been conducted in accordance with the normal practice in the area. The conditions for the sale at the auction had been displayed in front of the auctioneer's box. Attention was drawn to clause 12 of these conditions by the auctioneer's invoice and subsequent monthly statements. It stated in clear print that payment should be paid within 14 days from date of purchase, otherwise interest would be charged. At no stage was there any protest or query from McHaffie. Judgment was entered in the District Court for the auctioneer. The District Court ruled that interest was payable at a rate that had been shown in court to be the normal rate being charged and paid for unpaid amounts on stock purchases by farmers. The farmer appealed the decision on the grounds that the transaction was a controlled credit contract under which disclosure was required.

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43 (1990) 3 NZBLC 101, 847

Counsel for the auctioneer submitted that a charge of interest was customary according to the particular business involving the parties to this action, and at no stage was there any agreement between the farmer and the auctioneer by which the auctioneer was to loan moneys to the farmer or to extend credit in any way.

Williamson J held that the right to charge interest flowed clearly from the conditions of sale displayed prominently at the auction, and that the argument between the parties on whether the transaction was a controlled credit contract, which required disclosure, centred around the provisions of s.3(3)(b)(ii) of the Act.

In deciding whether the transaction was "in substance or effect a credit contract" [by virtue of section 3(4)] the definition of a credit contract in s.3(1) must be considered. When the totality of the evidence concerning the position between the farmer and the auctioneer was looked at, only s.3(1)(a) and (d) might have been applicable. The first required proof of an agreement by the auctioneer to lend while the second required proof that the farmer had promised to pay in the future. In this case there were no further discussions between the parties relating to interest, and therefore an absence of the required agreement or promise. The provisions of s.3(3)(b)(ii) therefore were not applicable as there was no credit contract within the meaning of the Act in this particular case.

Williamson J stated:[44]

> Another case referred to by Counsel was Wrightson NMA Ltd v Mead (1984) 1 NZBLC 102, 093, Gallen J. This case also concerned the sale of stock, namely a herd of sharemilking farm. There was no arrangement that the plantiff stock company would

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[44] Supra n.43 at 101, 850

provide the finance. Later, after the purchase of the stock had been completed, and when the purchasers had not received the amount of money which they anticipated from another source, other arrangements were made between the stock company and the purchasers as a result of which credit was extended. Mr Justice Gallen was careful to point out in his judgment at p 102, 096 that:

> "A credit contract is defined in s.3 of the Act. The section is detailed and comprehensive, but every arrangement which comes within the definitions contained within it is one which depends upon agreement."

In that case there had been discussions concerning extension of credit to the Meads. Mr Justice Gallen concluded that there was such an agreement and that it did come within the definition of a credit contract. He further held that the provision of s.3(3)(b)(ii) was not applicable ....

The difference between the Wrightson NMA Ltd v Mead case and the present case is that in this case there were no further discussions between the parties relating to interest.

With respect, it is submitted that His Honour was a little too slow to infer the necessary agreement, or exchange of promises, which would have converted the transactions into a credit contract, possibly with the assistance of section 3(4). This is particularly the case given the reasoning of Holland J in Patrikios whereby His Honour was prepared to infer the necessary agreement from a continued course of dealings, whereby regular and monthly notices that interest was running on the debt were received by Patrikios from United. It is submitted that the fact of a continued course of dealing in Patrikios, in contrast to the once-only purchase in

McHaffie, is not a factor which can be relied upon to distinguish the Patrikios reasoning on the McHaffie facts, because in Patrikios it will be recalled that it was held that each separate purchase by Patrikios from United following its receipt of the credit letter was a separate credit contract.

In this regard, His Honour noted[45] the arguments of counsel:

> For the Respondent it was argued that the evidence of the sale of the stock to the Appellant did not involve any arrangement to extend credit. It was submitted that at no stage had there been any agreement between the Appellant and the Respondent by which the Respondent was to loan moneys to the Appellant or to extend credit in any way. In contrast it was argued the Appellant had effectively helped himself to credit by failure to pay for the stock within the 14 days given for payment.

His Honour found[46] that there was an absence of the necessary meeting of minds, despite having found specifically that there was a right to charge interest in certain defined circumstances:

> The basis of Counsel's submission that there were two distinct transactions are the terms of the conditions for sale which require payment by cash but which allow the auctioneer to deliver the stock to the purchaser without payment in full and to debit the purchaser's account either with the auctioneer or with the purchaser's own stock and station agent. Clause 12, which appears to provide for the payment of interest by the purchaser, is, according to Counsel, restricted to the situation in which the purchaser is unable to finance the purchase through the Respondent or elsewhere. Remedies given to the auctioneer under

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45 Supra n.43 at 101, 849

46 Supra n.43 at 101, 848

> this clause, it was submitted, are limited to the situation where the auctioneer was acting as the vendor's agent and not as principal.
>
> After re-reading the relevant clauses and considering the submissions of both Counsel, I am of the view that there was only one transaction. The Appellant purchased stock from the Respondent as agent of the vendor. It was a term of this sale that the auctioneer as the vendor's agent would be entitled to recover not only the full amount of the unpaid purchase money but also interest calculated from the dale of sale. The rate of such interest was to be that charged by the auctioneer on overdue accounts. In this case there is no evidence of any separate transaction between the Appellant and Respondent. The right to charge interest flows clearly from the express terms of the conditions of sale.

With respect, it is difficult following His Honour's reasoning in this regard. If there was a sufficient meeting of minds, as His Honour had found, then surely there must also have been a sufficient exchange of promises to bring the transaction within, at least, section 3(1)(d), whereby the farmer can reasonably be interpreted to have agreed to pay a sum or sums in the future exceeding, in aggregate the cash price of the property sold to him, even if that promise was based on a contingency, ie. that payment in full would not be made on the due date.

It is submitted that since the stock was purchased on customary terms prominently displayed at the auction, His Honour should have found that the exception contained in section 3(3)(b)(ii) did not apply, and then proceeded to consider the appropriate end result by applying section 32.

This is particularly the case since the farmer made the purchase in early May 1985 and only managed a (part)

payment of $15,000 of the cash price of $15,101.75 in late April 1987. So, the charging of interest continued for some 23 months before any payment was made. Because of the lack of any required disclosure under the Act the farmer was, it is submitted, deprived of the ability to go "credit-shopping" to try to refinance the debt at more favourable rates to himself, regardless of whether, in fact, a more favourable deal was available.

Conclusions

1. For the reasons given above, the reasoning in Williams and Kettle Ltd v Duncan, Wrightson NMA Ltd v Mead and Patrikios Holdings Ltd v United Fisheries Ltd is to be preferred to the reasoning of Williamson, J in McHaffie v Pyne Gould Guiness. This statement should be qualified by the fact that, in Williams and Kettle, Master Williams felt himself compelled to decide in accordance with the preponderance of earlier authority on the issue, given the closeness of the fact situations in those early authorities to the factual situation which he was dealing with. One gets the clear impression that if a future set of facts presented itself which were more easily distinguishable from the fact situations in the earlier cases to which Master Williams referred, that the Master would have no hesitation in so distinguishing that line of authority and finding that the exception contained in section 3(3)(b)(ii) applied.

2. With the exception of Williamson J in McHaffie, it is discernible from the judgments that a factor influencing the decisions of their Honours was the fact that the Credit Contracts Act was intended to be extremely broadly based, to cover the full gamut of credit transactions, properly so described. Their Honours appeared reluctant to create what they may have seen as a trojan horse into the heart of the

philosophy behind the Act. In this regard the comments of Master Williams in Williams and Kettle[47] are particularly in point. It is submitted that in seeking to limit the applicability of the section 3(3)(b)(ii) exception to cases in which the provision in the contract is for liquidated damages by way of penalty for default, rather than to cases where the provision is really an option for the purchaser to pay cash or to pay interest on any balance overdue, the correct approach to the scope of the exception has been taken.

3. Perhaps the most startling factor of the above cases, is the considerable length of time that the debtors had been owing the sale price plus interest charges under the original contract, e.g. in McHaffie, there was a period of 2 years until the cash price payment was made by the debtor. It is submitted that it is repellent to common sense to continue to characterise a default which continues for this length of time, as continuing to fall within the exception created by section 3(3)(b)(ii). Surely, at some point in time an amount which may originally have been intended to be a spur to a purchaser to settle a cash transaction promptly, must metamorphose into an extended credit arrangement. Of course, a reasonable delimitation of this time threshold will necessarily vary from case to case. However, it is suggested that a "cut off point" be drawn at 2 months.

In selecting a period of 2 months, consistency is achieved with the exclusion from the meaning of credit contract contained in section 3(1)(i) which provides that:

> A contract for the sale of property, or the provision of services, to a person if the total

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47 Supra n.34 at 102, 414

> amount payable under the contract by the person (other than any amount payable solely as a result of a default in payment by him) is the agreed price of the property or services and is to be paid within 2 months from the date the contract is made. (Emphasis added)

4. Given that a major policy imperative of the Act is that credit transactions should be uniformly disclosed to facilitate credit shopping, then it is submitted that section 3(3)(b)(ii) should be amended by the addition of the words "provided that payment of any such amount does not continue beyond 2 months from the date that the contract is made". As stated above, it is submitted that this would provide a common-sense and reasonable (though, necessarily, arbitrary) additional limitation on the exception contained in section 3(3)(b)(ii) and would also bring this provision into line with section 3(1)(i), if the consequential amendments to that section recommended below are also adopted.

5. It must be noted that the exclusion contained in section 3(1)(i) is premised on a stipulation in the contract or transaction to the effect that the total amount payable under the contract is to be paid within 2 months from the date of the contract. In situations where there is no such stipulation contained in the contract, or which can not be implied, then the exception from the definition of "credit contract" does not apply. It is submitted that if the amendment to section 3(3)(b)(ii) recommended above is adopted, then section 3(1)(i) should also be consequentially amended by adding to the words in brackets in section 3(1)(i) as follows:

> (other than any amount payable solely as a result of a default in payment by him and

provided that payment of any such amount does not continue beyond 2 months from the date the contract is made).

6. Even though this issue has not been discussed above, for completeness it is submitted that the reference to "any reasonable amount" is inappropriate in section 3(3)(b)(ii). Its use is clearly intended to guide the courts towards making the distinction between a penalty provision and an amount of liquidated damages which is a genuine pre-estimate of loss arising from a default. If the payment is "reasonable" then, prima facie, it is not a penalty, and is therefore enforceable When looking at subparagraphs 3(3)(b)(i) - (v) one can see quite a clear rationale for inserting the word "reasonable" in all of those subparagraphs except, it is submitted, subparagraph 3.

The rationale in relation to the other subparagraphs is that as long as these amounts are reasonable, then a court can more easily draw the conclusion that such amounts provide extra value, whether in relation to a cash sale or a credit transaction, and so could not sensibly be classified as forming part of the total cost of credit.

In relation to section 3(3)(b)(ii) however, it is submitted that the attempt by the use of the word "reasonable" to draw the distinction between penalties and liquidated damages referred to above is strictly irrelevant to achieve the desired purpose of the subparagraph.

The issue of whether a payment is correctly identifiable as a penalty or as liquidated damages is a completely separate issue from whether the amount is payable as a result of default. It is submitted that it is only this latter issue which is relevant for the purposes

of the Credit Contracts Act. Accordingly, it is submitted that the word "reasonable" should also be deleted from the subparagraph.

Recommendations

1. Following from the above conclusions, it is recommended that section 3(3)(b)(ii) be amended to read:

   Any amount payable as a result of a default under the contract by the promisor provided that payment of any such amount does not continue beyond 2 months from the date the contract is made.

2. It is recommended that section 3(1)(i) be consequentially amended as follows:

   (i) A contract for the sale of property, or the provision of services, to a person if the total amount payable under the contract by the person (other than any amount payable solely as a result of a default in payment by him provided that payment of any such amount does not continue beyond 2 months from the date the contract is made)...

5. EPILOGUE

This paper has considered in depth 3 problem areas which the writer has identified in the course of his professional practice. There are, of course, quite a number of other problem areas which space has precluded from being given treatment in this paper.

Other outstanding legal problem issues which the writer has identified include the applicability of the Credit Contracts Act to simple lease transactions, the treatment of leases under the Hire Purchase Act 1971 for disclosure purposes (particularly in relation to disclosed residual values under leases) and the inter-relationship of the Credit Contracts Act, the Hire Purchase Act and the Door to Door Sales Act 1967. Each of these three statutes has its own particular disclosure regime. Section 52A of the Hire Purchase Act provides that the provisions of the Credit Contracts Act that apply to hire purchase agreements (deferred payment dispositions of property) shall apply in addition to the provisions of the Hire Purchase Act, and neither Act shall limit the provisions of the other.

Though this provision is deceptively simple, there is a myriad of problems which relate to exactly what has to be disclosed under the Hire Purchase Act to also comply with the disclosure requirements of the Credit Contracts Act. The disclosure requirements of the Credit Contracts Act are super-added on to the disclosure regime established under the Hire Purchase Act, but because of the structure of the Hire Purchase Act, and the rather complex definition of "total cost of credit" contained in the Credit Contracts Act, numerous extremely nasty problems arise in practice.

At the end of the day, while people theoretically must somehow do their best to comply with the disclosure regimes imposed by both Acts, there is a clear and urgent necessity to further co-ordinate the Acts so that there is a uniform disclosure regime established which applies to transactions under both Acts.

Also, hire purchase transactions in the context of door to door sales provide problems in relation to disclosure. The Door to Door Sales Act again has its own separate disclosure regime and issues arise about the necessity for disclosure of hire purchase transactions in the door to door sales context also complying with the full disclosure requirements of both the Credit Contracts Act and Hire Purchase Act. One could certainly be forgiven for describing this duplication and confusing overlap as legislative overkill.

There is also the problem of the correct disclosure treatment of pre-payments under the Credit Contracts Act in relation to hire purchase transactions. For example, if there is a disclosure error under the Credit Contracts Act then the cooling off period provided by section 22 of the Credit Contracts Act will not start until correct disclosure has been made. Under the Hire Purchase Act there is a separate disclosure regime, and once again the two regimes do not sit comfortably together. Also, in relation to modification disclosure of a credit contract, separate modification disclosure regimes are provided by the Credit Contracts Act and section 10 of the Hire Purchase Act. These regimes are inconsistent with each other in certain respects.

Another area of considerable uncertainty is the correct method of stating the finance rate in open-ended situations where the amount of credit and/or the total cost of credit is not known at the start of the contract, e.g. revolving credit facilities, floating interest rate loans, multi-currency facilities where future NZ dollar liabilities will be determined by the then prevailing NZ dollar cross-rate with the foreign currency being borrowed, and also progressive draw-down facilities, where the draw-down dates are at the (limited) discretion of the borrower (sections 6 and 5(2)(a)-(d).

There are also quite a few policy issues which would require discussion in any comprehensive review of the Act. The most important of these is the wide ambit of the Act and the mechanism used to distinguish "consumer" from "business transactions".

The Credit Contracts Act 1981 is unique throughout the world in applying to both consumer and business transactions. It can be persuasively argued that the exclusions relating to controlled credit contracts which are found in section 15 of the Act are inappropriate. In particular the $250,000 transaction threshold contained in section 15(1)(f) is generally regarded by the business community as being far too high. Over the years an informal consensus appears to have developed that a figure in the region of $50,000 would be an appropriate cut-off point above which disclosure, at least, would not have to be made. It is, of course, arguable that whether or not the

disclosure regime applies to controlled credit contracts whether the power to re-open oppressive credit contracts should also be so limited. Again, it is suggested that in relation to transactions involving more than $50,000 strong arguments could be put forward for suggesting that the re-opening provisions of the Act were inapplicable. The only caveat that the writer would make in this regard is that an exception would have to be made, at least, for major and essential consumer transactions, e.g. the purchase of a residential property. Again, there are some complex legal and philosophical questions which arise in the context of this debate.

Another policy issue relates to the validity of the credit shopping rationale, which has been discussed above in Section 2. It will be recalled that in that section the writer submitted that as it appears that very little credit shopping probably occurs in the vast majority of transactions, there can be strong arguments made, at least, for the repeal of the provisions relating to the 3 day cooling off period (section 22).

There are numerous other policy issues that could be addressed, such as the necessity to retain the disclosure regime in its current detailed form, through to the desirability of repealing the Act completely, given that in the 12 years since the Act was passed there has been a revolution in the New Zealand market place such that many categories of consumers of credit products would use the quality of extent of disclosure as a differentiator when deciding which credit provider to patronise. This would, of course, be to largely ignore the credit "underclass" whom the Act was also intended to protect.

Another approach to the continued necessity for all or part of the Act would be to argue that if unfair contracts legislation of general application is introduced, that this should be able to subsume and replace at least the Part 1 re-opening provisions and, together with the Fair Trading Act 1986, possibly also the disclosure regime in Part 2.

As can be seen, the policy issues that could be debated in relation to the Act are myriad and varied and the various answers given to the issues raised will perhaps depend more on the protagonists' philosophical leanings rather than on any nice points of law.

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