IN THE DISPUTES TRIBUNAL **[2012] NZDT 2**

BETWEEN	**AAJ**
	FIRST APPLICANT
AND	**AAK**
	SECOND APPLICANT
AND	**ZZR**
	RESPONDENT

Date of Order:	28 September 2012
Referee:	Referee Smallholme

ORDER OF THE DISPUTES TRIBUNAL

The Tribunal hereby orders that ZZR is to pay AAJ and AAK the sum of $15,000.00 with payment to be made by 5 pm on Friday 12 October 2012.

Facts

[1] On 20 July 2005, AAJ and AAK saw an advertisement in [a magazine] for [The Investment Scheme] created and managed by MT Ltd. The investment plan was advertised as:

> "[The Investment Scheme] is a unique plan which incorporates home equity release but dispenses with the usual high interest charges which eat rapidly into a family inheritance or leaves little for entry perhaps into a retirement village or similar. [The Scheme] is self-funding which leaves your property value virtually intact over a period of several years. The usual costs of setup fees, legal expenses, valuation etc are incorporated which means that the home owner does not have to reach for a cheque book ever!"

[2] In about September 2006, AAJ and AAK met ZZR of MT Ltd. ZZR recommended a detailed investment plan for AAJ and AAK, which was incorporated into a bound presentation booklet.

[3] On 31 October 2006, a Management Agreement was signed between MT Ltd and AAJ and AAK. Prior to signing the Management Agreement, AAJ and AAK took legal advice from LU, a solicitor. LU was recommended to them by ZZR. ZZR attended the appointment with them.

[4] The Management Agreement specifically included an arrangement whereby AAJ and AAK mortgaged their home; borrowed $227,500 from FI [a finance company]; received $50,000 for their personal purposes; paid MT Ltd an initial fee of $10,000 and ongoing fees of $409.98 every six months to provide ongoing management services, and investment of the balance of $163,993 with BO Ltd [an investment company] (initially for three years at 13.75%).

[5] Income was paid from the investment with BO Ltd and used to make the mortgage payments.

[6] ZZR visited AAJ and AAK at least twice a year and attended to their tax returns (under an authority with accounting firm UP Ltd) in 2007, 2008 and 2009.

[7] ZZR sold the business of MT Ltd which was sold to a third party in about December 2009.

[8] On 29 September 2009 AAJ and AAK took $155,766.06 from their investment account held with BO Ltd [the investment company] and on 1 October 2009 they loaned $150,000.00 to KL of BO Ltd. The terms of the loan included a three year term and interest at 13%.

[9] AAJ maintained he had contacted ZZR before KL's visit and sought advice about KL's personal and professional character, and that ZZR endorsed KL therefore they went on to enter the loan with him.

[10] ZZR stated he told AAJ that KL had always been "honest and upfront" with him. He denied that he specifically advised him to accept the proposal KL presented.

[11] The terms of the loan with KL were varied on 8 June 2010 with the interest rate reducing to 11.5% on a principal sum of $148,928.50. Ultimately KL defaulted on the loan. He repaid $152,000.00 on 9 November 2011.

[12] AAJ and AAK claim ZZR's conduct in advising them on the investment plan was misleading conduct in trade, particularly as to the nature, characteristics and suitability for purpose of the plan for their needs.

Law

[13] The relevant law is the Fair Trading Act 1986, particularly ss 2, 11, 43(1),(2) and (5).

[14] Regard has also been given to the High Court decisions of *Gilmour v Decisionmakers (Waikato) Limited and Hartles* [2012] NZHC 298; *Body Corporate 202254 v Taylor* [2009] 2

NZLR 17 (CA) and *Gloken Holdings Limited v The CDE Company Limited* (1997) 6 NZBLC 102.272.

Issues

[15] The issues to be determined are as follows:

(i) Did ZZR breach section 11 of the Fair Trading Act ("the FTA")?

(ii) Is the claim statute-barred?

(iii) If liability is established and the claim is not statute barred, then how much of AAJ and AAK's loss should be awarded?

(iv) If liability and quantum are found then can be ZZR be liable?

Findings

Breach of the FTA – s 11

[16] Section 11 of the FTA states:

> "No person shall, in trade, engage in conduct that is liable to mislead the public as to the nature, characteristics, suitability for a purpose or quantity of services."

[17] Adopting the test set out in *AMP Finance NZ Ltd v Heaven* (1997) 8 TCLR 144, the issues to be determined are:

(i) Whether the advice given by ZZR to AAJ and AAK about the investment plan was misleading as to the nature, characteristics and suitability for a purpose?

(ii) Were AAJ and AAK actually misled by the conduct?

(iii) In all the circumstances, was it reasonable that AAJ and AAK were misled by the conduct?

[18] The [Investment Scheme] presentation booklet held by AAJ and AAK (and presented at the hearing) was likely to be the version they had received (rather than the documents presented by ZZR, which were a copy of documents from his records).

[19] The [Investment Scheme] presentation booklet held by AAJ and AAK failed to state that the figures presented were dependent upon the re-investment of the annual tax refunds.

[20] Further, ZZR's conduct in returning the tax refunds to AAJ and AAK was misleading because it suggested the money did not need to be re-invested, the money was not re-invested, and therefore the scheme was not self-funding. ZZR's conduct in this regard did not reflect how critical it was to the funding of the scheme that these funds be re-invested annually.

[21] To the contrary, ZZR's letters to AAJ and AAK of 3 August 2007 and 12 May 2009 led them to believe that the funds were for their personal use. AAJ's letters advised them that their tax refunds had been deposited into their bank account. The letter of 3 August 2007 went further and stated "No doubt you will find a good use for them?"

[22] As noted in *Gilmour*, a reasonable financial advisor also has the task of developing an appropriate plan for his client. This requires ascertaining the client's objectives and assessing their tolerance to risk.

[23] The evidence established that the nature of the investment plan detailed in the Management Agreement of 31 October 2006 was not suitable for AAJ and AAK. The plan required AAJ and AAK to enter into a mortgage in a situation where they would be unable to fund the repayments because of their age and income, unless they re-invested their annual tax returns.

[24] My impression of AAJ and AAK was that they were relatively unsophisticated and even at the time of the hearings did not truly understand all of the aspects of the scheme. They were unaware that BO Ltd [the investment company] was authorised to use the capital sum to meet the shortfall. The capital sum subsequently reduced to $151,504.00. There was no formal consideration of how the mortgage repayments would be funded if interest rates dropped. There was no formal review of the investment plan and loan arrangements when the three year plan expired in late October 2009, therefore they were open to suggestion by KL when interest rates fell. AAJ and AAK were unable to critique the plan themselves and relied

on MT Ltd to provide this advice. By failing to given this advice, MT Ltd misled AAJ and AAK on the nature, characteristics and suitability of purpose of the plan. The plan was not one where AAJ and AAK would never have to reach for their cheque book.

[25] However, the evidence did not support a finding that ZZR had advised AAJ to enter into the loan agreement with KL.

Is the claim statute-barred?

[26] Section 43(5) of the FTA states any application made under section 43(1) (as it is here):

> "...may be made at any time within 3 years after the date on which the loss or damage, or the likelihood of loss or damage, was discovered or ought reasonably to have been discovered."

[27] The issue is when was it that AAJ and AAK discovered the loss (or likelihood of loss) or ought reasonably to have discovered the loss.

[28] As I have noted above, AAJ and AAK struck me as being unsophisticated and unaware of details of the scheme, the importance of re-investing the tax refunds, and how the investment plan would fail if interest rates fell.

[29] Against this background, the first point at which AAJ and AAK would have discovered, or ought reasonably to have discovered, the likelihood of loss was when on 29 September 2009 and 1 October 2009 (almost at the end of the three year management period) they entered into the further lending arrangements with KL. Those arrangements were made because BO Ltd [the investment company] could no longer offer the higher interest required to fund the mortgage repayments, and KL offered to assist AAJ and AAK so they could make the payments.

[30] AAJ and AAK filed their claim in the Disputes Tribunal on 18 April 2012, therefore their claim has been brought within three years of the date they ought reasonably to have discovered the deficiency in the scheme.

Loss

[31] AAJ and AAK submitted a document prepared by their current financial adviser which indicated that the total estimated cost of the investment plan to AAJ and AAK was $52,869.40.

[32] However, the direct costs associated with the misleading conduct as to the nature, characteristics, and suitability for a purpose of the scheme, are the costs involved in establishing the scheme. These are:

• Legal fees paid to LU [the solicitor]	$ 1,282.50
• Fees and incidental paid to LU [the solicitor]	$ 169.50
• Valuation fees	$ 395.00
• Lender's fees	$ 1,663.00
• MT Ltd management fee (initial)	$10,000.00
• MT Ltd management fees (ongoing)	$ 3,279.84
Total	$16,789.84

[33] These costs were incurred at the time the scheme was established. However, it was not until BO Ltd [the investment company] lowered its interest rate in 2009 and AAJ and AAK had to shift the investment to a personal loan with KL that they would have reasonably discovered the failure of their investment, that the scheme was not suitable for them, and that these initial costs were (in fact) losses.

[34] The limit of the Tribunal's monetary jurisdiction is $15,000.00 (there being no consent to an increase to $20,000.00). Therefore, an order can be made up to this amount only, and there has been no consideration of the further losses claimed by AAJ and AAK for the difference in interest charges between FI [the finance company] and a standard bank, penalties incurred in breaking the FI loan, or the shortfall in investment repayments.

Is ZZR personally liable?

[35] For ZZR to be personally liable it will need to be established that he was acting "in trade" for the purposes of the FTA. Section 2 defines "in trade" as:

> "**trade** means any trade, business, industry, profession, occupation, activity of commerce, or undertaking relating to the supply or acquisition of goods or services or the to the disposition or acquisition of any interest in land".

[36] In the Court of Appeal case of *Body Corporate 202254 v Taylor* [2009] 2 NZLR 17 (CA), it was found that a person does not need to be trading in a personal capacity to be considered "in trade" and that an employee, agent or director of a company may be personally engaged "in trade" for the purposes of the FTA. This is despite the fact that the person is not trading on his or her own account.

[37] As stated at paragraph 87 of *Gilmour*:

> *Gloken Holdings Limited v The CDE Company Limited* (HC Hamilton CP28/95, 24 June 1997) is also authority for the proposition that where a person is the manager or director and where the breach of the Fair Trading Act is theirs, they can be considered the "alter ego" of a company and will be personally liable. A director who participates directly in his or her company's business will not ordinarily be able to avoid liability under s 9 of the Act and such representations must be regarded as in trade for the purpose of the liability under s 9.

[38] The Courts have attempted to achieve a balance between recognising the nature of the corporate structure (the principle of limited liability) and consumer protection.

[39] I am satisfied by the following facts that ZZR's representations about the investment scheme were personal representations by ZZR (and not simply statements made by him as the company's agent or servant):

(i) The advertising feature that AAJ and AAK responded to presented a photograph of ZZR and a photograph of a client – ZZR was seen to be actively promoting the investment scheme.

(ii) ZZR was at all relevant times the sole director of MT Ltd.

(iii) On all occasions ZZR met personally with AAJ and AAK and personally advised them about the investment scheme.

(iv) ZZR was the only person from MT Ltd that dealt with AAJ and AAK.

(v) ZZR attended to AAJ and AAK's tax returns every year.

[40] Therefore, under the *Gloken* principle, ZZR is the alter ego of the company and should be personally liable under s 11 of the FTA for the losses suffered by AAJ and AAK up to the maximum of the Tribunal's jurisdiction of $15,000.00.