



Consumer Law Reform Additional Paper – October 2010

Referencing Good Faith in a Fair Trading Act Purpose Clause

In June 2010, the Ministry of Consumer Affairs released the discussion paper “Consumer Law Reform”.¹ The discussion paper included a section on Principles-Based Law (pages 21-26) and proposed inserting a purpose clause in the Fair Trading Act 1986 to emphasise that it is principles-based legislation, and as an aid to interpretation. For discussion purposes, it was suggested a purpose clause could be along the following lines:

“To promote consumer well being by fostering effective competition and enabling the confident participation of consumers in markets in which both consumers and suppliers trade fairly and in good faith.”²

About half of the submissions received commented on the proposed purpose clause. There was a range of views in submissions from those who supported having a purpose clause, to those who could not see any advantage from a purpose clause, to those who were concerned about the use of particular words. Various issues regarding the proposed purpose clause will need to be resolved, but the most controversial element of the proposed purpose clause was the suggested reference to “good faith”. This paper provides further analysis about the appropriateness of including a reference to good faith in the purpose statement.

Including good faith reference in a purpose clause would increase uncertainty

The most common argument advanced against including a reference to good faith in the purpose clause is that the meaning of the term is uncertain, and the uncertainty would create transaction costs and litigation risk for traders.

Many of the submissions on the discussion document which have argued the uncertainty point seem to have assumed that the good faith reference in a purpose clause would create a general good faith obligation in the Fair Trading Act.

The function of a purpose clause as an aid to interpretation and a statement of the principles underpinning the Fair Trading Act does not seem to have been understood very well. The intention is that the principle of good faith should be taken into account and should inform the judgements made by suppliers when they assess their own compliance with the Fair Trading Act, and the judgements made by Courts when they consider issues such as whether a trader has been misleading or deceptive under section 9, or has made a false or misleading representation under sections 13 – 16 of the Fair Trading Act. The reference to good faith in the purpose clause would not be intended to create any new or separate obligation in its own right.

¹ www.consumeraffairs.govt.nz/legislation-policy/policy-development/consumer-law-reform

² Final drafting of any purpose statement will be undertaken by the Parliamentary Counsel Office. The suggested purpose statement for the Fair Trading Act included in the discussion document was indicative only to allow for consultation and discussion regarding general direction.

The submissions which have criticised including good faith have tended to emphasise that it is a nebulous and uncertain concept. This argument is over-stated. “Good faith” is defined and referred to in the Sale of Goods Act 1908 in relation to the passing of clear title in goods (e.g. sections 25, 27 and 28). Secured parties under the Personal Property Securities Act 1999 are required to exercise their rights, duties and obligations in “good faith and accordance with reasonable standards of commercial practice” (section 25). The Fair Trading Act itself has a reference to good faith in relation to the defences for non-compliance with consumer information standards (section 44).

The meaning of good faith in abstract terms is actually very clear; it relates to honesty and openness. Where there has been uncertainty and academic debate about the meaning of good faith has been where it is argued that good faith requires more than honesty, and that a party which has acted honestly but grossly negligently (for example) might not be able to be said to have acted in good faith. This uncertainty could be avoided by a definition of good faith which clearly emphasises actual honesty, rather than reasonableness.

In many instances, the law already gives effect to the principle of good faith. For example, the prohibition on conduct in trade that is misleading or deceptive under section 9 of the Fair Trading Act is effectively synonymous with an obligation to act honestly and in good faith. The false and misleading representation offences under sections 13 – 16 of the Fair Trading Act apply to traders that do not act honestly and in good faith.

The Courts tend to apply an honesty and good faith standard when they enforce these provisions in the Fair Trading Act. For example, an honest but incorrect statement of opinion by a trader in a contractual negotiation will not be regarded as a misrepresentation or misleading or deceptive conduct under the Fair Trading Act, while expressing an incorrect opinion which is not honestly held will be a misrepresentation or misleading or deceptive conduct. A statement of opinion will only be a misrepresentation if it is a lie; the misrepresentation or lie is that the opinion is honestly held, rather than that the opinion is necessarily right.³ Not being allowed to lie is the essence of a good faith obligation.

A reference to good faith in the purpose clause would therefore be an accurate description of how the Fair Trading Act works in those cases, so such a reference may be useful from a transparency point of view, but it would not add anything to the substance of the legal analysis. However there are other cases where a reference to good faith in the purpose clause might not be an accurate description of how the Fair Trading Act works.

Fair Trading Act does not always require parties to act in good faith

There are situations (and there have been cases) where parties have not breached the Fair Trading Act, even though they have *not* acted honestly and openly towards each other. In those cases, the law might not be giving effect to the principle of good faith. An example of this situation is where a party to a business-to-business transaction deliberately withholds information, to the detriment of the other party, but there is no remedy under the Fair Trading Act because the party incurring the detriment did not reasonably look after its own interests. A remedy in respect of misleading or deceptive conduct is only available if it is “reasonable” for the party to have been misled, irrespective of whether the misleading party was acting in good faith. The Courts have been very reluctant to treat non-disclosure as a misrepresentation, and they have continued to value the principle of *caveat emptor* for business-to-business transactions despite the Fair Trading Act.⁴

³ *Premium Real Estate v Stevens* [2008] NZCA 82, *David v TFAC Limited* [2009] NZCA 44

⁴ *Des Forges v Wright* [1996] 2NZLR 758 (Elias J), *Janus v Fairhall* [2009] NZCA 280

The Courts have also given effect to terms in business-to-business contracts that effectively contract out of the Fair Trading Act, including the remedy against misleading and deceptive conduct. Generally the Courts will not give effect to a clause in a contract which openly excludes the remedies under the Fair Trading Act, but the Courts have recently given effect to clauses in business-to-business contracts which provide for an alternative basis for the parties to allocate risk between themselves. These contract clauses may exclude a trader from being responsible for any pre-contractual representations, which effectively excludes any remedy for misrepresentation or misleading or deceptive conduct under the Fair Trading Act.⁵

The principle of good faith is therefore a standard that businesses are not necessarily required to meet in business-to-business transactions under the Fair Trading Act. Even if a reference to good faith in the purpose clause does not create a separate good faith obligation under the Fair Trading Act, it could change the statutory context that the Courts interpret and apply in relation to particular cases. It should be noted that this is only likely to apply in relation to business-to-business contracts; the Courts can be expected to continue to hold businesses to higher standards of honesty when they deal with consumers. The problem with uncertainty in relation to the principle of good faith is not that the meaning of good faith is uncertain; the problem is that it is uncertain how the Courts would either apply or get around the principle in cases where businesses have been permitted to fall short of a good faith standard in their dealings with other businesses, without being held to have breached the Fair Trading Act.

Some of the business submissions on the discussion paper have expressly said that a good faith standard is inappropriate for business-to-business transactions, and that including the principle of good faith in the Fair Trading Act would intrude on businesses' freedom of contract and the principle of *caveat emptor*. These submissions emphasise that the Fair Trading Act is primarily and most importantly business law, rather than consumer law. Presumably these submitters are likely to welcome the opportunity for businesses to contract out of the Fair Trading Act in their business-to-business transactions.

However most of the business submissions approached the issue of including good faith in the purpose clause from the certainty point of view, rather than arguing that businesses need to have the right to deal with each other without being constrained by the good faith principle. If the certainty issue was the primary concern it could be managed by providing a clear definition of good faith for the purposes of the Fair Trading Act. There are various definitions available from case law and other legislation, and the main point is that good faith requires honesty, and that parties can make a mistake, or even act carelessly or negligently, while still acting in good faith.

The New Zealand Bankers' Association also raised an interesting point. They observed that the Fair Trading Act does not involve any positive obligations in Part 1: all the obligations are negative (e.g. no person shall engage in misleading or deceptive conduct, no person shall make a false or misleading representation, no person shall demand payment for goods they do not intend to supply etc). The New Zealand Bankers' Association commented that we need to be careful in deriving a positive principle (such as consumers and suppliers trading in good faith) from a series of negative obligations.

We agree that it is important to be careful in deriving the principles for a purpose clause from the policies underlying the Fair Trading Act. However this is a wider issue than the question about whether to include a reference to good faith, and the issue about deriving positive principles from negative obligations applies equally to any other positive statement in a purpose clause (such as a reference to "trading fairly", for example).

⁵ *David v TFAL Limited* [2009] NZCA 44, *PAE v Brosnahan* [2009] NZCA 611

Consumer groups and some businesses have submitted that requiring businesses to behave honestly can only be good, and that referring to good faith in the Fair Trading Act would therefore be appropriate. It is arguable that the ethical value of good faith and honesty has an economic value in promoting trust in markets for the benefit of businesses as well as consumers, and that sharp practices which are permitted without breaching the existing provisions of the Fair Trading Act are effectively a loophole.

Consumers may not benefit from a good faith reference in a purpose clause

There are however other reasons why it would be better not to include the reference to good faith in the purpose clause, and these are more persuasive than the certainty argument and the argument that businesses should be free to not act in good faith between themselves.

First, although the Fair Trading Act generally requires suppliers to act honestly towards consumers, the good faith principle does not fit with most of the offences under the Fair Trading Act because they are strict liability offences, where the intention of traders who might have breached the Act is irrelevant. For example, a misrepresentation under section 14 is required to be a contractual representation about a particular fact (as distinct from a non-contractual opinion about a future fact which may or may not be honestly held), but the intention of the party making the misrepresentation is irrelevant.

The focus of the test is on whether the outcome of the conduct complained about was a party being misled such that they should be protected by the law; the good faith of the party being misleading has no bearing on the outcome. A party who is accidentally or carelessly misleading may still be in breach of section 14, even if the party acted in good faith.

The only qualification to the strict liability of traders for the offences under the Fair Trading Act is that the defences available under section 44 include the defendant making a reasonable mistake, or reasonably relying on information from someone else. However these are different from a “good faith” defence. A defendant could make an *unreasonable* mistake, or *unreasonably* rely on information from someone else in good faith, and still have committed an offence under the Act.

Therefore the Fair Trading Act requires *more* than good faith from traders in the context of making misrepresentations to consumers in particular. A statement in the purpose clause which says traders are required to trade fairly and in good faith would therefore *understate* current obligations and thus would reduce strict liabilities.

The Commerce Commission also raised the concern that a reference to good faith in the purpose clause could be used by lawyers to argue that the defences in section 44 should be broadened to effectively limit the strict liabilities under the Fair Trading Act. The particular concern is that a reference to good faith in the purpose clause may affect the “reasonableness” standard in section 44, making them easier defences to make out if the party had acted in good faith. This could effectively limit the usefulness of the Fair Trading Act in protecting consumers, which would obviously be an unintended consequence of adding a reference to good faith in the purpose clause.

Another factor is that the Layby Sales Act, Door to Door Sales Act and the Unsolicited Goods and Services Act create various rights for consumers which have nothing to do with good faith of consumers or traders, and if the regulatory requirements of those Acts are added to the Fair Trading Act then the good faith principle would not be relevant to them.

The same point applies in relation to the product safety and information standards provisions under the Fair Trading Act.

Conclusion

The fact that adding a reference to good faith in the purpose clause for the Fair Trading Act would be controversial because some businesses in particular consider the term is uncertain is not necessarily a persuasive reason not to proceed with the proposal.

The fact that some businesses do not consider they should be required to meet a good faith standard in their business-to-business transactions is interesting, especially in the face of the existing provisions in Part 1 of the Fair Trading Act. It is particularly interesting that the analysis is consistent with how the Courts have applied the Fair Trading Act in business-to-business transactions.

This may be a policy concern, and we would welcome feedback on it. Adding a reference to good faith in the purpose clause could be a tentative, and quite probably ineffective, way of dealing with this issue. Other steps, such as prohibiting contracting out of the Fair Trading Act in form or substance, or providing that knowingly withholding material information is a misrepresentation, would be more effective in dealing with the business-to-business issues related to good faith. These would be substantive policy proposals in their own right, and would require significant further analysis.

The more significant concern with the reference to good faith in the purpose clause from a consumer law perspective is that it is not in fact an accurate statement of the principles of the Fair Trading Act. Most of the offences in the Fair Trading Act are strict liability offences, so the Fair Trading Act requires more of traders than good faith, particularly in their dealings with consumers. The reference to good faith in the purpose clause would therefore be inaccurate, and there is a risk that it could be used to strengthen the defences available to traders, and therefore to reduce the protections available to consumers. This is a risk that is not worth taking.

Recommendations

We are continuing our analysis on a possible purpose clause for the Fair Trading Act. The above analysis supports any purpose clause not including a reference to good faith.

We would welcome any additional feedback on this paper, including:

- whether contracting out of the Fair Trading Act in form or substance should be prohibited, or
- whether the Fair Trading Act should provide that knowingly withholding material information is a misrepresentation.

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