IN THE SUPREME COURT OF NEW ZEALAND

SC 40/2015
[2016] NZSC 53

BETWEEN	SPORTZONE MOTORCYCLES LIMITED (IN LIQUIDATION) First Appellant
	MOTOR TRADE FINANCES LIMITED Second Appellant
AND	COMMERCE COMMISSION Respondent

Hearing:	10 and 11 November 2015
Court:	Elias CJ, William Young, Glazebrook, Arnold and O'Regan JJ
Counsel:	D J Goddard QC, I J Thain and C M Moody for Appellants S J Mills QC, K C Francis and P J L Arnold for Respondent
Judgment:	12 May 2016

JUDGMENT OF THE COURT

A The appeal is dismissed.

B The appellants must pay the respondent costs of $25,000 plus reasonable disbursements (to be determined by the Registrar in the absence of agreement between the parties). We certify for two counsel.

REASONS
(Given by O'Regan J)

[1] This appeal addresses the provisions of the Credit Contracts and Consumer Finance Act 2003 (the 2003 Act) regulating fees charged by financiers to consumers under consumer credit contracts.

[2] The appellants, Sportzone Motorcycles Limited (in liquidation) (Sportzone) and Motor Trade Finances Limited (MTF), provided finance to consumers in connection with the purchase of motorcycles from Sportzone. Sportzone assigned each consumer credit contract to MTF under an arrangement between Sportzone and MTF. MTF then became the creditor under the assigned contracts.

[3] The respondent (the Commission) alleged that the fees provided for in these consumer credit contracts were unreasonable for the purposes of the 2003 Act. After an eleven day hearing in the High Court, Toogood J delivered a judgment in which he found that the fees were, in some respects, unreasonable (the HC liability judgment).[1] In a subsequent judgment (the HC quantum judgment), Toogood J quantified the extent to which the fees were unreasonable.[2]

[4] Sportzone and MTF appealed to the Court of Appeal which dismissed the appeal against both the HC liability judgment and the HC quantum judgment.[3]

[5] This Court gave Sportzone and MTF leave to appeal on the following question:[4]

> Did the Court of Appeal err in finding that the fees charged by [Sportzone and MTF] were unreasonable for the purposes of s 41 of the Credit Contracts and Consumer Finance Act 2003?

[6] Sportzone and MTF also sought leave to appeal on a second question. However, leave to appeal on that question was declined.[5]

The financing arrangements and the fees charged

[7] As its name suggests, MTF provides funding facilities for motor vehicle dealers. Sportzone was one of these dealers. In 2004 Sportzone purchased 10,000 shares in MTF and entered into an MTF dealer agreement. Under that agreement,

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1 *Commerce Commission v Sportzone Motorcycles Ltd (in liq)* [2013] NZHC 2531, [2014] 3 NZLR 355 [HC liability judgment].

2 *Commerce Commission v Sportzone Motorcycles Ltd (in liq)* [2014] NZHC 2486 [HC quantum judgment].

3 *Sportzone Motorcycles Ltd (in liq) v Commerce Commission* [2015] NZCA 78, [2015] 3 NZLR 191 (Harrison, Stevens and Simon France JJ) [*Sportzone* (CA)].

4 *Sportzone Motorcycles Ltd (in liq) v Commerce Commission* [2015] NZSC 97.

5 The second question was: “Did the Court of Appeal err in finding it had been established that the debtors had suffered loss or damage for the purposes of s 94 of [the 2003 Act]?”

Sportzone was authorised to provide intending purchasers of motorcycles with finance for periods between one and five years with security taken over the relevant motorcycle to secure the obligations of the debtor. The present case relates to 39 transactions under which Sportzone provided funding to debtors (who were purchasing motorcycles from Sportzone) under a document called an "MTF Credit Contract". Sportzone then drew down from MTF an advance of a sum equal to the amount advanced by Sportzone to the debtor and assigned its interest in the credit contract and the security interest over the motorcycle to MTF.[6] We will call these advances from MTF to Sportzone "MTF loans".

[8] MTF funded its operations through a securitisation programme, short term loans and capital received from shareholders. The securitisation programme involved MTF assigning its interests in credit contracts and security interests to an associated company, MTF Securities Limited (MTFS).[7] MTFS then securitised the transactions and sold them on the Euro-commercial paper market. Payments made by debtors to MTFS in relation to the amounts due under the credit contracts discharged the obligations of Sportzone to pay equivalent amounts to MTF under the MTF loans. Most of the 39 MTF consumer credit contracts at issue in the present appeal were assigned by MTF to MTFS.

[9] Under the 2003 Act, all of Sportzone, MTF and MTFS (in relation to the loans onsold to it) are creditors in relation to the consumer credit contracts with the motorcycle purchasers.

[10] The fees payable under the credit contracts that are the subject of this proceeding were:

(a) An establishment fee of $200 charged by Sportzone.

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6 All of the transactions involved debtors who were natural persons, who borrowed for the purpose of purchasing a motorcycle and did not purchase the motorcycle primarily for business purposes. Thus, all were consumer credit contracts to which the 2003 Act applies: s 11.

7 MTFS was a defendant in the High Court proceedings but was not a party to the appeal to the Court of Appeal or to the present appeal.

(b) An establishment fee of $190 charged by MTF.[8]

(c) A monthly account maintenance fee of $5 charged by Sportzone.

(d) A monthly account maintenance fee of $3 charged by MTF to Sportzone and by Sportzone to the debtor.

(e) A full prepayment administration fee of $50 charged by MTF to debtors who fully repay their loans before the date on which the last payment was due. This was not challenged.

(f) A fee of $5 charged by MTF and described in the loan documents as a "PPSR Financing Statement Registration Fee".[9] This was not challenged.

[11] The credit contracts also provided for the payment of fees in the event of a default occurring. These were:

(a) A prepossession fee of $50 charged by MTF to debtors in arrears for 12 days. This fee was increased to $80 for credit contracts entered into after 2 February 2007.

(b) A $70 repossession fee charged by MTF to debtors in arrears for 34 days. This fee was increased to $80 for credit contracts entered into after 2 February 2007.

[12] Although the appeal was advanced on behalf of both Sportzone and MTF, the focus of the argument was on MTF's position (Sportzone is now in liquidation).

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8 Included in the establishment fees charged by MTF and Sportzone is a charge of $6.35 plus GST payable to Baycorp for a credit check of the debtor and a portion of the cost of a Land Transport Safety Authority charge for a motor vehicle check, the cost of which ranged from $0.20 to $2.68 per debtor. MTF submitted in this Court that the establishment fee that could have been charged under the Commission's approach was $63 in 2006, $88 in 2007 and $70 in 2008.

9 This is the fee for the registration on the Personal Property Securities Register of a financing statement in relation to the security interest in the motor vehicle perfecting the security interest for the purpose of the Personal Property Securities Act 1999.

[13] MTF's approach to the fees it charged apparently developed as a result of a review it undertook after the 2003 Act was passed. After that review, MTF altered its fee structure to recover a greater proportion of operating costs through fees, rather than through interest charged on consumer credit contracts. MTF claimed that its fees did not completely cover its operating costs and that the increases in the level of fees were matched by a reduction in its interest rate margin. Evidence given at the trial from MTF executives was to the effect that the increased fee income did not, in fact, lead to increased profitability per transaction. MTF adduced evidence showing that the amount of its fees was not out of line with the fees charged by selected competitors.

[14] There was evidence before the High Court that the Board of MTF had treated the introduction of the 2003 Act as presenting "profit opportunities", including the chance to increase fee income. The Commission highlighted evidence that one of MTF's senior executives commented that attempts to claw back provisions and bad debts through fees "would be wrong", but this did not deter MTF from seeking to recover such items through fees.[10]

[15] The Commission's case was that the review undertaken by MTF involved a full cost-absorption model, which was aimed at recovering all costs incurred in running MTF's business from fees, other than MTF's cost of funds (essentially, interest costs), the cost of its securitisation programme and the cost of capital employed in its business.[11] The review involved MTF dividing its expenses into separate "cost centres" containing a number of cost categories and line items. For each financial year, MTF undertook a separate allocation of each line item to one or more of the four different fee categories it was using. These were establishment fees, account maintenance fees, prepayment fees and default fees.[12] The costs for each fee category were divided by the estimated number of fees MTF expected to charge in the next 12 month period to derive a fee per transaction and then compared to existing or proposed fees.

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[10] "Provisions" referred to provisions against bad debts, in particular dealer loss and fraud. See *Sportzone* (CA), above n 3, at [22].

[11] "Cost of capital" was defined in the HC quantum judgment, above n 2, at [90] as "the cost of funds used to finance a business" which, in MTF's case, was "what [MTF] considers its shareholders require as an acceptable rate of return in order to stay invested in the business".

[12] There was some variation in the names given to these fees.

[16] The basis for this exercise appears to have been MTF's view that, as its only business was the provision of credit, all of its costs (subject to the above exceptions) were recoverable in one of the fees it charged its customers.[13] Its chief executive, Mr Todd, confirmed this in cross-examination. One of MTF's expert witnesses, Professor Lont, explained in cross-examination that all MTF's business costs related to its financing business could be described as having a "beneficial relationship" with that business and could therefore be recovered in fees without infringing the requirement not to charge unreasonable fees. We will come back to this argument later.

[17] MTF says it did not in fact recover in its fees all costs other than interest costs incurred by MTF. For example, it says in 2006, it recovered 77 per cent of such costs in fees and the remaining 23 per cent in interest charges. It is not clear to us how much of the 23 per cent mentioned by MTF relates to the other exceptions identified by the Commission (securitisation costs/cost of funds) and therefore unclear to what extent the positions of MTF and the Commission differ. However, we do not see it as necessary to resolve this because it is not a decisive factor in our analysis of the issues before us.[14]

Statutory scheme

[18] The 2003 Act is consumer protection legislation. It has recently been amended but the provisions to which we refer are those in force before the Credit Contracts and Consumer Finance Amendment Act 2014 came into force. The purposes of the 2003 Act are set out in s 3, which at the time relevantly provided:

> **3 Purposes**
>
> The purposes of this Act are–
>
> (a) to protect the interests of consumers in connection with credit contracts, consumer leases, and buy-back transactions of land; and

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13 This assumes these costs were not incurred as a result of inefficiency or "gold plating". MTF's counsel accepted in argument that recovery of such costs would not be reasonable.

14 We were told that, in 2007, MTF's model identified costs equal to $235.06 for the activities associated with the establishment of each loan but charged an establishment fee of $190.

(b) to provide for the disclosure of adequate information to consumers under consumer credit contracts and consumer leases–

    (i) to enable consumers to distinguish between competing credit arrangements or competing lease arrangements; and

    (ii) to enable consumers to become informed of the terms of consumer credit contracts or consumer leases before they become irrevocably committed to them; and

    (iii) to enable consumers to monitor the performance of consumer credit contracts or consumer leases; and

(c) to provide rules about interest charges, fees, and payments in relation to consumer credit contracts;

…

[19] Paragraph (a) underscores the significance of the consumer protection purpose of the 2003 Act. Paragraph (b) emphasises the importance of disclosure of information to consumers and subparagraph (b)(i) makes it clear that this is required to allow for easy comparison of competitive financing options. This objective of comparability of consumer credit contract terms was emphasised in argument by the Commission. Paragraph (c) is the most directly relevant purpose in the present context but, although it describes the provisions dealing with fees as "rules", it does not provide any guidance about the interpretation of those provisions.

[20] Part 2 governs consumer credit contracts.[15] A consumer credit contract is defined as a credit contract where the debtor is a natural person who enters into the contract predominantly for personal, domestic or household purposes, and certain other conditions apply.[16] Subpart 2 provides for the required disclosure of a creditor under a consumer credit contract in relation to certain matters.[17]

[21] Subpart 3 of Part 2 establishes the circumstances giving rise to a debtor's right to cancel.

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15 Credit Contracts and Consumer Finance Act 2003, s 10.

16 Section 11. All the credit contracts at issue in these proceedings are consumer credit contracts.

17 Sections 17–26.

[22] Subpart 4 of Part 2 provides for standards of disclosure.

[23] Subpart 5 of Part 2 deals with interest charges. It ensures that the contract specifies the annual interest rate applicable under the contract,[18] and that interest is (generally) charged in arrears on the outstanding balance of the credit provided.[19] Although Subpart 5 regulates interest and default interest charges, it does not impose any restrictions on the rate of interest that may be charged under a consumer credit contract.[20]

[24] Subpart 6 of Part 2 deals with fees payable under consumer credit contracts. It contains the provisions at issue in the present appeal. The prohibition on unreasonable fees is found in s 41, which at the relevant time provided:[21]

> **41 Unreasonable credit fee or default fee**
>
> (1) A consumer credit contract must not provide for a credit fee or a default fee that is unreasonable.
>
> (2) If the court is satisfied, on the application of the Commission, a debtor, or a guarantor, that a credit fee or default fee is unreasonable, it may order that the fee be annulled or reduced.
>
> (3) The court may make any other order it thinks fit for the purpose of giving effect to an order under subsection (2).
>
> (4) An application for an order may be made within 1 year of the day that the fee is imposed or debited under the consumer credit contract.

[25] Section 41 applies to all credit fees and default fees, but it is supplemented by more specific provisions that guide the Court in determining whether s 41 has been breached. In the present case, the decision on the reasonableness of the establishment fees charged by Sportzone/MTF is guided by s 42, whereas the decisions on the reasonableness of the account maintenance fee (which is a "credit fee" under the 2003 Act) and the default fee are guided by s 44.

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18 Section 37.
19 Section 38.
20 However, a credit contract that provided for an interest rate that is considered "oppressive" would be liable to be reopened: see s 120.
21 The section was amended in 2014. The effect of the amendment was to delete subs (2)–(4).

[26] In the present appeal, the focus was on the *level* of the fees charged by Sportzone/MTF, rather than on the reasonableness of charging any fee. On the face of it, the charging of a fee that could not be justified at all would also fall foul of s 41. The section appears to cover both whether the charging of any fee at all is reasonable as well as whether the level of the fee is reasonable. The power given to the Court under s 41(2) to "annul" a fee that is found to be unreasonable, when juxtaposed with the power to reduce the fee, suggests that is the case. In the present case, the Commission did not argue that any of the fees charged by Sportzone or MTF were unreasonable per se. Its argument was aimed solely at the level of the fees. For this reason we do not express a view as to whether the existence of any of the fees was unreasonable in itself.

Establishment fees

[27] The term "establishment fees" is defined as follows:[22]

> **establishment fees** means the fees or charges payable under the credit contract that relate to the costs incurred by the creditor in connection with the application for credit, processing and considering that application, documenting the contract, and advancing the credit; but does not include any fee or charge to the extent that it is a charge for an optional service

[28] Section 42 deals with establishment fees:

> **42 Establishment fees**
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> In determining whether an establishment fee is unreasonable, the court must have regard to–
>
> (a) whether the amount of the fee is equal to or less than the creditor's reasonable costs in connection with the application for credit, processing and considering that application, documenting the consumer credit contract, and advancing the credit; or
>
> (b) whether the amount of the fee is equal to or less than the creditor's average reasonable costs of the matters referred to in paragraph (a) for the appropriate class of consumer credit contract.

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22 Section 5.

Other credit and default fees

[29] Both credit fees and default fees are defined in the 2003 Act:[23]

> **credit fees** means fees or charges payable by the debtor under a credit contract, or payable by the debtor to, or for the benefit of, the creditor in connection with a credit contract (including any insurance premiums payable if the creditor requires the debtor to obtain insurance cover from a particular insurer); but does not include the following:
>
> (a) interest charges:
>
> (b) a charge for an optional service:
>
> (c) a default fee or default interest charge:
>
> (d) government charges, duties, taxes, or levies.
>
> …
>
> **default fees** means fees or charges payable on a breach of a credit contract by a debtor or on the enforcement of a credit contract by a creditor; but does not include default interest charges

[30] Section 43 deals with prepayment fees. Such fees are not in issue in this appeal, but s 43 is of interest because it takes a different approach from the sections around it. Rather than setting out one or more facts to which a Court must have regard, as ss 42 and 44 do, it provides that a prepayment fee is unreasonable "if and only if [the fee] exceeds a reasonable estimate of the creditor's loss arising from the [prepayment]".[24] Section 44(1) sets out the relevant criteria for determining the reasonableness of *other* credit or default fees. It provides:

> **44 Other credit fees and default fee**
>
> (1) In determining whether a credit fee or a default fee is unreasonable, the court must have regard to,–
>
> (a) in relation to the matter giving rise to the fee, whether the fee reasonably compensates the creditor for the following:
>
> (i) any cost incurred by the creditor (including the cost of providing a service to the debtor if the fee relates to the provision of a service):

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[23] Section 5.

[24] Section 43(1)(a) and (b). See the discussion at [86] below.

(ii) a reasonable estimate of any loss incurred by the creditor as a result of the debtor's acts or omissions; and

(b) reasonable standards of commercial practice.

…

[31] Section 44(2) makes it clear s 44 does not apply to establishment or prepayment fees.

[32] Part 3 is not relevant to the present case.[25]

[33] Part 4 deals with enforcement and remedies. Subpart 3 of Part 4 includes ss 93 and 94.

[34] Section 93 gives the Court power to make certain orders if a person has suffered loss or damage by conduct of a creditor that constitutes a breach of certain provisions of the 2003 Act including those in Part 2, Subpart 6. These orders are specified in s 94 and include an order directing a refund, the payment of compensation and the payment of exemplary damages.[26]

[35] Subpart 4 of Part 4 deals with offences. It includes s 103, which provides that every creditor or transferee who breaches certain provisions (including ss 41 to 44) commits an offence. The maximum penalty for an individual is a fine of $200,000 and for a body corporate a fine of $600,000. Section 106 provides for a "reasonable mistake" defence.

[36] Counsel for MTF, Mr Goddard QC, expressed the concern that the breach of the open-textured requirements of ss 41–44 should expose the finance company concerned to criminal sanctions. We agree that this concern is justified given the broad wording of those sections. The present litigation illustrates the room for differing views over what is required for compliance with them.

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25 There is now a Part 3A but this was inserted by the 2014 Amendment Act.

26 The proposed second ground of appeal (for which leave was declined) related to the application of this provision in the present case.

[37] Subpart 7 of Part 4 contains provisions relating to the Commission. Section 111(1) provides that the Commission's role is to promote compliance with the 2003 Act and s 111(2) sets out the Commission's functions in relation to the Act. These include monitoring trade practices in credit markets, initiating prosecutions and taking civil proceedings, as the Commission has in this case.

[38] Part 5 contains provisions relating to the reopening of credit contracts. Section 120 authorises the Court to reopen a credit contract if it is oppressive, the rights under the credit contract are or are to be exercised in an oppressive manner or a party has been induced to enter into the credit contract by oppressive means.[27]

[39] To summarise, ss 41–44 address four different types of fee – establishment fees, prepayment fees, other credit fees and default fees. Such fees must not be "unreasonable". This assessment involves the court considering, in the case of establishment fees under s 42, "reasonable costs" or "average reasonable costs"; in the case of prepayment fees under s 43(1), a "reasonable estimate" of the creditor's loss (including the creditor's "average reasonable administration costs"); and in the case of other credit fees under s 44, reasonable compensation for (i) any cost incurred by the creditor and (ii) a reasonable estimate of any loss incurred by the creditor, as well as "reasonable standards of commercial practice". Obviously, the concept of reasonableness is central to the scheme of these provisions. The repeated resort in the provisions to reasonableness as a standard suggests first, that the assessment is an objective rather than a subjective one and second, that it was intended to place a real constraint on what creditors are entitled to charge by way of fees.

The lower Courts' approach

[40] There were two High Court judgments, the HC liability judgment and the HC quantum judgment. In the HC liability judgment, Toogood J summarised the approach he would take in the following paragraphs:

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27 "Oppressive" is defined in s 118 as "oppressive, harsh, unjustly burdensome, unconscionable, or in breach of reasonable standards of commercial practice".

> [65] … The overriding consideration is that of reasonableness contained in s 41. Reasonableness is to be judged from the view of an informed objective bystander considering whether it is reasonable for the particular borrower to meet the costs which the lender seeks to recover by the fees charged. That exercise is not assisted by a test which, in effect, permits a creditor to justify any fee on the basis that it is simply recovering an actual business cost incurred by the creditor, other than the cost of the funds advanced, no matter how remote the cost may be from the transaction in which the fee is charged.
>
> [66] Bearing in mind the statutory purposes identified and the focus of the statutory wording upon particular transactions, it is appropriate to adopt the test from [*Yurjevich v Commissioner of Inland Revenue*].[28] To be reasonable, the cost the creditor seeks to recover must be sufficiently close and relevant to the establishment of the particular loan, to the administration and maintenance of the particular loan, or to the actual consequences of the particular default, such that it can reasonably be said that the cost was incurred in connection with or in relation to the relevant matter.

[41] MTF had suggested a test for establishing whether the expressions "in connection with" in s 42(a) and "in relation to" in s 44(1)(a) were met if there was a "beneficial relationship" between the costs sought to be recovered and the activity for which the fee was being charged. The Judge rejected this, adopting the narrower approach set out above. This was in part because the Judge considered that both s 42 and s 44 were transaction-specific.[29] He considered that it was not right to make allocations of costs by reference to certain activities of the finance company, rather the determination of reasonableness of any cost recovery had to be made in respect of a particular loan and, in the case of establishment fees, the four activities referred to in s 42(a).

[42] The Judge considered that his more restrictive interpretation was in line with the purposes of the 2003 Act, which he saw as:[30]

> (a) consumer protection;
>
> (b) the provision of adequate information [to debtors];

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28 *Yurjevich v Commissioner of Inland Revenue* (1991) 13 NZTC 8,185 (HC). That case related to a claim that travel costs were deductible under a provision allowing a tax deduction for "expenditure incurred in connection with the preparation, institution or presentation of [the taxpayer's] objection". Savage J said this required "a link or connection which is sufficiently close and relevant to the preparation, institution or presentation of the objection that it can reasonably be said that the expenditure was incurred in connection with it": at 8,189.

29 HC liability judgment, above n 1, at [38].

30 At [63].

(c) identifying the circumstances in which fees can be charged, and the levels of them; and

(d) assisting the enforcement of lender obligations.

[43] In the HC quantum judgment, the Judge applied this approach to the fees. We will discuss the exercise he undertook later.

[44] The Court of Appeal upheld the High Court decisions. In doing so, it affirmed the approach advocated by the Commission. The Court was satisfied that ss 42 and 44 create a scheme requiring the costs that a creditor seeks to recover in respect of a particular fee activity to be "sufficiently close and relevant" to the activity.[31]

[45] The Court's reasons were:

(a) The required connection in the provisions between the relevant fee and the costs incurred in generating it support that approach. Given the statutory context, close connection was required so that the interpretation of this section reflected the statutory purposes of the 2003 Act.[32]

(b) This interpretation was also consistent with the legislative history, which indicated that the 2003 Act was intended to protect a particular class of vulnerable consumers by ensuring transparency and disclosure in credit contracts.[33]

(c) This interpretation was also supported by the explanatory note to the Bill which became the 2003 Act.[34] In particular the explanatory note made it clear that the test in relation to s 42 (cl 37 of the Bill) was "designed to ensure that creditors matched fees to the specific cost of

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31 *Sportzone* (CA), above n 3, at [51], citing the HC quantum judgment, above n 2, at [66].
32 At [52], citing *Hatfield v Health Insurance Commission* (1987) 15 FCR 487 at 491.
33 At [54].
34 Consumer Credit Bill (2002) 2–1 (explanatory note) at 8.

the matter giving rise to the fee". A similar statement was made in relation to s 44 (cl 39).[35]

(d) While the Court accepted that it was open to a creditor to put in issue some particular factor which might impact on what is reasonable (in addition to the costs connected with the relevant activity), the Court considered there was little scope for holding reasonable an establishment fee that exceeded the creditor's average reasonable costs in relation to the four matters specified in s 42(a).[36]

(e) The specific wording of the relevant provisions also supported the conclusion.[37] In particular, use of the definite article before the words "matter", "creditor" and "debtor" in s 42(a) illustrated the statutory emphasis on "actual, specific costs and the specific quantum of estimated loss".[38]

MTF's case

[46] MTF's case is that the Courts below were wrong to determine that fees were unreasonable to the extent that they were greater than the amount necessary to recover costs closely connected with the task or activity to which the fee related.

[47] MTF's primary position is that the inquiry is not confined to the costs incurred by a creditor. MTF says that the assessment of reasonableness under s 41 must be undertaken "in a broad common-sense manner, informed but not determined by consideration of a reasonable estimate of costs that are expected to be incurred by the creditor". MTF says if this test is applied to the fees it charged in relation to the 39 consumer credit contracts at issue in the appeal, the outcome is that the fees are not unreasonable in terms of s 41 because it was open to a reasonable creditor to charge fees at the level charged by MTF. Accordingly, MTF did not breach its obligation under the 2003 Act.

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35 At [55].
36 At [57]–[58].
37 At [59].
38 At [60].

[48] MTF says one of the important non-cost factors which must be taken into account in assessing reasonableness is the level of fees charged by other entities in the relevant financing market. It points to the fact that its fees were not out of step with those charged by a number of its competitors in respect of similar lending transactions during the period that the 39 contracts were entered into.

[49] MTF's secondary argument is that, to the extent that costs are taken into account (MTF accepts that under ss 42 and 44 this is a mandatory relevant consideration), the costs should not be limited to those "closely connected" to a specific activity, but rather be any costs that contribute to the lender's ability to undertake the relevant activity. This would include both variable and fixed costs and direct and indirect costs. MTF's case is that the test for determining whether costs are rightly recoverable in the relevant fee is to ask whether the cost is "beneficially related" to the activity for which the fee is being charged. The outcome of that test is the inclusion of all costs as outlined above.

[50] During the hearing of the appeal, MTF's counsel, Mr Goddard, put forward a fall-back argument on the measurement of costs. He argued that MTF should be allowed to recover its avoidable costs in relation to the activity for which the relevant fee is being charged. He defined "avoidable costs" in relation to any business activity as the costs that MTF would avoid if it ceased undertaking that activity altogether (such as, if it were to outsource the activity). Mr Goddard accepted that this measure of cost had not been advanced as a possibility by MTF in either the High Court or the Court of Appeal, but argued that the evidence in the High Court dealt with avoidable costs without using that terminology. He pointed to the evidence about the measure of variable cost, and in particular whether the measurement should be based on short term or long term variable costs. He argued that long term variable costs were, in essence, the same as avoidable costs.

Commission's position

[51] The Commission seeks to uphold the Court of Appeal judgment. In essence, the Court of Appeal decision adopted the arguments made by the Commission in that Court.

Issues

[52] The issues which arise are:

(a) What are the relevant purposes of the 2003 Act? In particular, is one of the purposes of the 2003 Act flexibility in pricing models and the encouragement of innovation by creditors?

(b) What approach to the assessment of the reasonableness of fees provides the best basis for comparing credit offerings by competing credit providers?

(c) Should fees be assessed on a per transaction basis or by reference to the activities undertaken by the creditor?

(d) What measure of costs should be adopted? The possibilities canvassed in argument were (short term) variable costs, variable costs plus some allowance for fixed costs as found by the High Court, avoidable costs or any cost beneficially related to the activity for which the fee is charged.

(e) Whether the Court should consider the fall-back argument advocating an avoidable costs measure, given that it has not been raised in the lower Courts.

(f) Whether the assessment of the reasonableness of fees should be based on cost only, or on a broader consideration as advocated by MTF.

(g) Whether the fact that averaging is permitted affects the method of determining the reasonableness of fees.

(h) Whether the approach of the lower Courts leads to absurd outcomes and, if so, whether this should lead us to adopt a different measure in an effort to avoid those outcomes.

[53] We will consider these issues in turn and then address the question on which leave to appeal was granted.[39]

Purposes of the 2003 Act

[54] Section 5(1) of the Interpretation Act 1999 says that the meaning of an enactment must be ascertained from its text and in light of its purpose.

[55] Section 3 of the 2003 Act as it stood at the relevant time set out clearly what the purposes of the 2003 Act were.[40] In the present case the most relevant of these stated purposes are those set out in s 3(a) (protection of the interests of consumers in connection with credit contracts) and s 3(b)(i) (providing for the disclosure of adequate information to consumers to enable them to distinguish between competing credit arrangements). Mr Goddard accepted these were important purposes of the legislation and important factors in the interpretation of ss 41–44. But he argued that an equally important purpose was the provision of flexibility to creditors in their pricing arrangements and the encouragement of innovation by creditors. He argued that the interpretation advocated by MTF gave effect to those purposes whereas the approach advocated by the Commission and accepted by the lower Courts did not.

[56] Mr Goddard also downplayed the importance of comparability between competing credit offerings and argued that this should be seen as of less significance than the encouragement of flexibility in pricing options and innovation by creditors.

Flexibility

[57] The High Court Judge accepted that the promotion of pricing flexibility was one of the objectives of the 2003 Act.[41]

[58] Mr Goddard pointed to the explanatory note to the Bill,[42] in particular the regulatory impact and compliance costs statement that appears at the end of the

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39 See [5] above.
40 See [18] above.
41 HC liability judgment, above n 1, at [59].
42 Consumer Credit Bill 2002 (2-1) (explanatory note).

explanatory note.[43] The "statement of the problem and the need for action" section of the regulatory impact statement identifies the problems with the regime that existed before the 2003 Act came into force, referring to the fact that the regulatory framework had become "outmoded and ill-suited to modern credit products and practices".[44] The "statement of the public policy objective" says:[45]

> The regulation of consumer credit has clear goals. These goals could not be achieved without Government intervention, as there are key elements of market failure identified with consumer credit, as well as equity problems.
>
> The goals are to –
>
> - Promote efficient credit markets; and
> - Provide for effective information disclosure …
> - Allow pricing flexibility for lenders; and
> - Provide adequate incentives for compliance by all parties to a credit transaction; and
> - Discourage oppressive conduct.

[59] Mr Goddard said that the promotion of an efficient credit market was not only a goal, but was the first mentioned goal of the reform. Pricing flexibility was also specifically included as one of the goals of the legislative reform.

[60] He also pointed to the policy papers that preceded the introduction of the Bill, which likewise referred to the need for pricing flexibility and the encouragement of innovation.[46]

[61] Like the High Court Judge, we acknowledge that the promotion of efficiency and the facilitation of pricing flexibility were factors driving the reform. But it is notable that neither of these factors was mentioned in s 3 of the 2003 Act, which sets out the purposes of the legislation as expressed by Parliament, as opposed to the officials involved in the preparation of policy papers and the explanatory note to the Bill. We do not discount efficiency and pricing flexibility as a factor to be taken into

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43 At 19–25.
44 At 19.
45 At 20.
46 Ministry of Consumer Affairs *Consumer Credit Law Review Part 1: Setting the Scene* (June 1999); and Ministry of Consumer Affairs *Consumer Credit Law Review Part 3: Transparency in Consumer Credit: Interest, Fees and Disclosure* (April 2000).

account, but we think it is clear from the express words of s 3 that Parliament saw the need to protect consumers and to allow for comparability between competing credit offerings as more important purposes.

[62] Mr Goddard said that the approach adopted by the lower Courts and advocated by the Commission led to a number of consequences compromising efficiency and curtailing pricing flexibility. We will deal with these aspects of Mr Goddard's submission when we come to the "absurd consequences" heading.

Comparability

[63] The significance of the objective of comparability between competing credit offerings was strongly disputed. Mr Goddard said that the decision by the legislature to move away from a disclosure regime requiring the overall cost of credit to be disclosed indicated that comparability was not a paramount consideration.[47] Once the decision was made to make that change and the alternative option of requiring all charges to be included in the interest rate was rejected, Parliament was mandating a regime which was a mixed fee/interest model. By definition, that model meant that the comparability between offerings arose from the disclosure of the quantity of fees and interest.

[64] Counsel for the Commission, Mr Mills QC, argued that the Commission's approach to the assessment of the reasonableness of fees was consistent with the comparability objective in s 3(b)(i) of the 2003 Act. If the approach upheld in the High Court and Court of Appeal based on variable costs is adopted, the result will, by definition, be lower fees than would arise from the application of MTF's approach. This means that the proportion of the overall cost of credit met by the borrower that is represented by the interest charge will be greater, and that will be the main focus of the price competition between credit providers. Mr Mills relied on the evidence of Dr John Small and said that this approach was supported by MTF's witness, Mr Mellsop. However, Dr Small accepted in cross-examination that the fact

47 Under the Credit Contracts Act 1981, which was repealed by the 2003 Act, a creditor was required to disclose the total cost of credit and a finance rate that factored in both interest and fees.

that providers will have different variable costs meant that even a variable costs requirement would not solve the comparability problem.

[65] Parliament's rejection of the approach requiring disclosure of the overall cost of credit (as was required under the Credit Contracts Act 1981) means that comparing competing offers is more difficult under the 2003 Act than under the previous legislation. But that does not mean that comparability is unimportant under the 2003 Act. The express reference to comparability in s 3(b)(i) confirms this. Ultimately we see the Commission's approach as more consistent with the comparability objective in s 3(b)(i) for the reasons advanced by Mr Mills.

[66] Enhancing comparability also advances another important purpose of the 2003 Act, the protection of consumers, particularly vulnerable consumers.

Consumer protection

[67] The first purpose mentioned in s 3 of the 2003 Act is that of protecting consumers. It was common ground before us that this was an important purpose of the 2003 Act. As we have said, we see the enhancement of comparability as consistent with that purpose. In addition, the constraint on the level of fees in ss 41 to 44 achieves the purpose of prohibiting the charging of excessive fees. Mr Goddard disputed that this protected consumers, because the corollary of limiting fees would be increasing the headline interest rate, so consumers would not be better off in net terms. We do not see that as axiomatically correct. Given that the focus of price competition will be on the interest rate, there will, assuming competitive market conditions, be market constraints on increasing interest rates. We consider therefore that the interpretation of ss 41 to 44 adopted in the Courts below can be seen as more consistent with the consumer protection purpose in s 3(a) than the broad interpretation proposed by MTF, which would not constrain the level of fees a creditor could charge to any significant extent.

Transaction-specific?

[68] Section 42 refers to two alternative cost bases for determining the reasonableness of establishment fees. The first refers to the creditor's costs "in

connection with *the* application for credit, processing and considering *that* application, documenting *the* consumer credit contract and advancing *the* credit".[48] As the Court of Appeal noted,[49] the highlighted definite articles indicate a statutory emphasis on specific transactions. Section 44 contains similar indications: for example s 44(1)(a)(ii) refers to the loss incurred by *the* creditor as a result of *the* debtor's acts or omissions. This cannot sensibly be seen as referring to acts and omissions of debtors generally or even debtors of a particular class. Rather it focuses on the individual debtor on whom the fee is levied.

[69] The second cost basis for determining the reasonableness of establishment fees is the average reasonable costs in connection with the factors listed at [68] above for the appropriate class of consumer credit contract.[50] There is no reference to averaging in s 44 in relation to credit fees and default fees.[51]

[70] In the lower Courts, the reference to "average reasonable costs" in s 42(b) was taken as allowing a creditor to charge an establishment fee based on the average costs per transaction rather than requiring the costs to be calculated for each individual transaction.[52] However, this did not affect the determination of which costs could be brought to account in determining the overall figure from which the average calculation was made.

[71] Mr Goddard argued that the need for averaging in determining the level of fees to be charged supports MTF's approach. This is because averaging envisages that all costs of the activity in question will be the starting point, with the average being determined by dividing that overall figure by the number of transactions expected to be entered into in the relevant period.

[72] We do not accept that averaging gives any indication of the appropriate costs measure. All it envisages is that whatever cost measure is used, an average can be calculated by dividing the figure by the number of transactions. Given the context in

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48 Section 42(a) (emphasis added).
49 *Sportzone* (CA), above n 3, at [29] and [59].
50 Section 42(b).
51 However, the process of setting credit fees will require a calculation of the costs of providing the relevant service for the anticipated number of times the service will be provided and then dividing that figure by that anticipated number to derive a per-transaction fee.
52 HC liability judgment, above n 1, at [86], quoted in *Sportzone* (CA), above n 3, at [42].

which s 42(b) appears (as an alternative to the single transaction approach in s 42(a)), we see the cost measure as that which represents the total amount of anticipated transaction-specific costs for the anticipated number of transactions.

[73] To summarise, the transaction-specific approach contrasts starkly with MTF's approach to setting fees as outlined above.[53] In brief, that approach was to allocate (virtually all of) its costs of operation to activities referable to the fees it proposed to charge. The underlying assumption was that all those costs were recoverable in fees and that such fees would be reasonable in terms of s 41 of the 2003 Act. In light of the transaction-specific focus of ss 41–44, the approach should have to identify what steps were undertaken in relation to particular aspects of the provision of credit under a consumer credit contract and calculate the costs of taking those steps. Where averaging is permitted, this should be done for a representative sample of transactions so that the average cost per transaction can be assessed. Costs incurred in carrying on MTF's business that are not referable to the identified steps are not recoverable in fees, but are still recoverable in the interest rate charged to debtors.

[74] This accords with the overall scheme of the 2003 Act, which provides for no limit on the interest rate that can be charged but limits fees to those that are reasonable both in nature and extent. The 2003 Act can be seen as starting from the premise that charges will be levied as interest, with the exception of fees that are subject to the reasonableness limitation.

[75] It is also consistent with the approach taken in other contexts. Mr Mills pointed to cases in which courts have distinguished between costs sufficiently closely related to the service or activity to be included in the charge for the service or activity and those that are considered to be part of the general overheads of the entity.[54]

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[53] See [12]–[17] above.

[54] *Carter Holt Harvey Ltd v North Shore City Council* [2006] 2 NZLR 787 (HC) at [18]; *Air Caledonie International v Commonwealth of Australia* (1988) 165 CLR 462 at 470.

Cost measure

[76] There was no dispute that cost recovery is an important component in the assessment of reasonableness of fees, because both ss 42 and 44 specifically refer to cost as a mandatory relevant consideration.

[77] The Commission's approach requires a transaction-specific assessment of the costs of a particular service for which a fee is charged, albeit with some averaging, which focuses on the variable cost of providing the particular service to the particular creditor. The High Court accepted that this was the correct approach in principle, but in the HC quantum judgment the High Court Judge also made some limited allowance for fixed costs.[55]

[78] MTF's position was that, to the extent that costs are relevant to the assessment of reasonableness, all costs should be allowed to be taken into account as long as they were beneficially related to the activity for which the fee is being charged. In the High Court MTF argued that all costs are variable in the long run, and so what will be considered variable in the present context will depend on the time period used. Ultimately the High Court Judge indicated that variable costs should be assessed as follows:[56]

> [86] First, the employer should assess the time taken by the responsible employee or employees to consider, process and document each loan. Plainly an averaging approach to the assessment would be appropriate for the purpose of setting fees even though individual cases might involve more or less time than the average. Second, an allocation of the employer's total cost of remuneration (including salary and other benefits) should be undertaken. Third, allocating the total cost of remuneration to the time taken to establish the loan would provide an indicative range for the fee.
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> [87] In an appropriate case, it might be reasonable to add other variable costs having a cause or link to the establishment of the loan, and fixed direct costs other than employee remuneration which may include IT costs properly referable to the establishment activities.

[79] The variation to the pure variable costing approach was derived from the evidence given by the Commission's expert witness, Mr Cregten, a forensic accountant. He suggested that some fixed costs could be seen as being sufficiently

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[55] HC quantum judgment, above n 2, at [11].

[56] HC liability judgment, above n 1.

closely connected to a service for which a fee is charged that they ought to be able to be reflected in a reasonable fee. He said that these included a proportion of the costs of premises space used by personnel involved in establishing contracts and also part of MTF's IT costs.

[80] As is apparent from the quotation above, Toogood J accepted that evidence. So did the Court of Appeal. It endorsed the application of a cost accounting methodology. It found, contrary to the evidence of MTF's expert, Professor Bowman, that MTF's approach in allocating virtually all of its company overheads (including fixed and indirect costs) to fees was not a reasonable accounting practice.[57] It rejected MTF's "beneficial relationship" test noting that its proponent, MTF's expert witness Professor Lont, had himself acknowledged that the test became subjective once it moved beyond cause and effect and was more difficult to relate to the statutory requirements.[58] It concluded that Toogood J was right to reject that test.[59]

[81] The Court of Appeal accepted that the best approach was that adopted by the High Court Judge, which was based on the evidence of Mr Cregten.[60] As noted earlier, this involved a variation to a variable costs approach, allowing for fixed costs to be included in the calculation of a fee where they are proved to be relevant and closely connected to the activity for which the fee is charged.[61]

[82] We do not see any error in the approach taken by the High Court and Court of Appeal. Ultimately, as the Court of Appeal acknowledged, the Court's task is one of statutory interpretation involving assessment by the Court rather than by expert witnesses.[62] While most of the argument before us focused on definitions of costs, we think that the Court's attention must be focused clearly on the wording of the 2003 Act itself. Much was made of the High Court Judge's use of the term "closely connected" but we do not think that the Judge was proposing an alternative to the statutory test when he used that phrase. Rather, he was applying the test that had

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57 *Sportzone* (CA), above n 3, at [74].
58 At [76].
59 At [77].
60 HC liability judgment, above n 1, at [83]; *Sportzone* (CA), above n 3, at [80].
61 See above at [79].
62 *Sportzone* (CA), above n 3, at [2].

been articulated in *Yurjevich v Commissioner of Inland Revenue*, which he considered could be adopted in the present context.[63] The phrase "closely connected" was shorthand for that test. So it was a shorthand phrase to describe the ambit of the costs that can reasonably be included in a fee within the confines of the statutory wording. We do not see the phrase "closely connected" as a substitute for the words of the Act.

Avoidable cost?

[83] Mr Goddard sought to advance an alternative argument in this Court to the effect that the correct approach to determining whether fees were reasonable was to adopt an avoidable cost methodology. This would allow MTF to recover all costs that it would cease to incur if it were to discontinue the particular activity. This argument had not been raised in the High Court or Court of Appeal. The Commission may have called further evidence from its experts if it had known that this was the approach that it needed to counter. Mr Goddard argued that, even though avoidable cost had not been dealt with by that name in the High Court proceedings, the experts had given views on, and been cross-examined on, long term variable costs which, he said, was effectively a synonym for avoidable costs.

[84] We do not consider that it is appropriate for this new approach to be raised in this Court for the first time. The Commission should not have to face this argument without the ability to obtain evidence from its experts as to its applicability and as to the practical implications if it were to be adopted. We do not therefore evaluate it further, apart from observing that its focus on "activity" does not seem to us to address the focus in ss 41–44 on individual transactions, rather than activities within the relevant financial institution.

Factors other than cost

[85] Mr Goddard argued that the Courts below had erred by effectively determining that cost was the only relevant factor when assessing the reasonableness of establishment fees under s 42 and other credit and default fees under s 44. He pointed out that the drafting style adopted in those sections was to impose on the

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[63] See above at [40] and n 28.

decision-maker a requirement to "have regard to" certain factors. There was nothing to indicate that these factors were exclusive and no restriction on the Court considering any other matter that it considered to be relevant.

[86] Mr Goddard contrasted the wording of ss 42 and 44 with that of s 43, which makes it clear in relation to prepayment fees that the only determinant of reasonableness is whether the fee reflects a reasonable estimate of the loss caused by the early repayment.[64] As Mr Mills pointed out, the drafting of s 43 reflects the reality that the loss caused by early repayment is readily calculable in each individual case. We do not see s 43 as providing any assistance in the interpretation of ss 42 and 44.

[87] Mr Goddard also drew support from the provision in the National Credit Code of Australia dealing with unconscionable interest and other charges.[65] He said this provision and its predecessors have been interpreted in the manner MTF now advocates. That provision is concerned with unconscionable aspects of individual transactions. The adoption of similar language in New Zealand in a different context (a provision dealing with reasonableness, not unconscionability) is perhaps surprising. But the context is important and we do not think much assistance can be derived from the Australian texts and authorities given the different context in which the provisions apply in New Zealand.

[88] Mr Goddard referred to the decision of the Court of Appeal in *Sanford Ltd v New Zealand Recreational Fishing Council Inc*.[66] In that case the Court of Appeal was considering the power of the Minister of Fisheries to settle various sustainability measures for certain fish stocks under s 11(1) of the Fisheries Act 1996. Section 11(2) of that Act required the Minister to have regard to any provisions of legislation or instruments made under legislation that applied to the coastal marine area. Five different categories were outlined.

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64 See above at [30].

65 This is now National Consumer Credit Protection Act 2009 (Cth), Schedule 1, National Credit Code, cl 78. Mr Goddard referred to authorities on an earlier but identical provision.

66 *Sanford Ltd v New Zealand Recreational Fishing Council Inc* [2008] NZCA 160.

[89] The Court of Appeal adopted an interpretation of the phrase "have regard to" from an earlier Court of Appeal decision, *New Zealand Fishing Association v Ministry of Agriculture and Fisheries*.[67] The Court said in its judgment in *Sanford*:[68]

> The requirement is to give the matter genuine attention and thought, but it remains open to the decision-maker to conclude that the matter is not of sufficient significance to outweigh other contrary considerations.

[90] Mr Goddard said that that meant in the present case the Court was required to:

(a) give genuine attention and thought to the costs incurred by the creditor;

(b) take all other factors that shed light on reasonableness into account; and

(c) form an overall view on the reasonableness of the fee in question, in which cost considerations would not be decisive and could be outweighed by other considerations.

[91] We do not believe that the analysis in the *Sanford* case can be applied in the context of s 42 or s 44. There are a number of reasons for this:

(a) The provision at issue in *Sanford*, s 11(2) of the Fisheries Act, set out a wide range of factors to which the Minister was required to have regard. There was no indication of the relative importance of these factors and the weight to be given to each one was left to the Minister. In contrast to this, s 42 has only one factor to which regard must be had, namely cost (albeit there are two alternatives) and it is therefore obvious that an obligation to have regard to one particular factor is quite different from an obligation to have regard to a number of different factors which may even be mutually exclusive. The same

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67 *New Zealand Fishing Association v Ministry of Agriculture and Fisheries* [1988] 1 NZLR 544 (CA), at 551 per Cooke P.

68 *Sanford Ltd v New Zealand Recreational Fishing Council*, above n 66, at [95].

can be said about s 44, although in that context there is also a reference to reasonable commercial practice.

(b) Section 11(2) of the Fisheries Act dealt with a power of a Minister to settle various sustainability measures for stocks of fish, effectively a rule making power. In the present case the decision relates to the reasonableness of fees charged by a particular lender in connection with particular lending transactions. The focus of the legislature on the relationship between the level of fees and the costs incurred by the provider of the financial services is obvious, and in those circumstances the need to take close account of the level of costs is also obvious.

(c) The formulation set out in the *Sanford* decision is more applicable to a situation where there are a number of different factors to which regard may be had, and these may have broadly varying significance in the context of the decision being made.

[92] However, we agree with Mr Goddard that the language of ss 42 and 44 does not require the Court to treat costs as the only relevant consideration. That said, we do not think Parliament contemplated the possibility that a Court would be able to conclude that factors other than cost could outweigh cost in the determination of the reasonableness of fees. That would require attributing to Parliament an intention that a factor not mentioned in s 3 outweighs the single factor (cost) that is required by the relevant sections to be taken into account. We accept that other factors, such as the level of fees charged by other providers may be relevant to the determination of reasonableness, assuming the fees charged by others are, themselves, at a reasonable level.[69] That is particularly so in relation to credit fees, given the express reference to reasonable commercial practice as a relevant factor.

[93] MTF's case is that its fees are not out of step with those of its competitors and therefore must be reasonable. However, given the focus on costs in ss 42 and 44, the proposition that similarity with competitors indicates reasonableness cannot

[69] As did the Court of Appeal: *Sportzone* (CA), above n 3, at [57].

be accepted at face value, because it does not take into account the relationship between the costs of the competitors and the fees they charge. Nor can it be assumed that competitors' practices are, themselves, reasonable commercial practice. As Mr Mills pointed out, an approach based on the proposition that fees that are comparable with those of competitors are thereby reasonable would effectively limit the scope of unreasonableness to those whose fees are "outliers". There is nothing in the statutory language to support that approach and it does not appear to us to be consistent with the purposes of the 2003 Act identified earlier.

[94] To conclude, we accept cost is not the sole determinant of reasonableness. But, like the Court of Appeal, we do not see much scope for finding that fees that are calculated to recover costs not associated with the activities for which the fee is charged being found to be reasonable because of some non-cost-based factor.[70] MTF has not identified any such factor here. We do not see competitors' fee levels as materially assisting its case.

Absurd outcomes?

[95] In its submissions, MTF argued that the approach of the lower Courts led to absurd outcomes and must therefore be wrong. We evaluate its allegations of "absurdities" below.

Training of staff

[96] MTF argued that it was absurd that under the approach of the Courts below, some staff costs are taken into account in assessing reasonable fees but others are not. In particular, that approach permits recovery through fees of the salary cost of front-line staff who do credit checks and approve loans, but not the cost of training those staff to perform those activities, or the cost of hiring those staff, or the cost of supervising and managing them. MTF argued that all of those costs were equally necessary in order to have staff who can process the loans efficiently.

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70 *Sportzone* (CA), above n 3, at [58].

[97] We see this as neither absurd nor attributable to the approach of the Courts below. It simply follows from the statutory scheme and its focus on transaction-specific costs. The assessment of reasonableness requires lines to be drawn. Expenses close to the line on either side of it may seem similar and hard to differentiate. The only way of avoiding line drawing is to allow all costs to be included, as MTF contends for. But that approach does not meet the statutory limitation of the level of fees to those that are reasonable.

[98] MTF's approach would require that costs of any activity by MTF in relation to the proposed provision of credit should be captured in establishment fees, even if the activity was undertaken in relation to proposals that did not proceed, either because MTF declined to provide credit or the intended customer decided not to proceed. We do not think that approach reflects the statutory scheme. The establishment fee for a consumer credit contract should reflect the costs of establishing that contract, but not costs incurred in work undertaken for proposed transactions with others that did not proceed.

Allowing depreciation but not costs of ownership

[99] MTF also argued that it was absurd that the approach of the Courts below permits recovery through fees of a depreciation allowance for the computer hardware and software used by relevant staff, but not other costs of ownership of the same assets, such as the cost of capital invested in those assets. MTF sought to recover its cost of capital at a rate of 17.5 per cent per annum.

[100] In the High Court there was evidence from Mr Mellsop, the expert economist called by the appellants, to the effect that only economic measures, but not financial accounting measures, typically incorporate "cost of capital". The Judge observed that "it is difficult to see how any allowance could be made for an accounting item which is not an actual cost incurred…"[71] The Judge found the cost of capital should be recovered through interest payments; it was too remote from any particular transaction to justify recovery through fees.[72]

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[71] HC quantum judgment, above n 2, at [94].
[72] At [94].

[101] We see no absurdity in this. The cost of capital is a general cost of the business structure. It is not in any way related to specific transactions. MTF's argument depends on its approach of allocating all costs to one or other fee being accepted. It is not. We agree with the High Court Judge that it is appropriate to require MTF to recover the cost of capital in its interest rate.

Contracting out

[102] Another "absurdity" argument made by MTF relates to the hypothetical possibility of contracting out services it currently provides in-house. It says the approach of the Courts below would enable the full cost (including a profit margin) of loan establishment or debt recovery or any other activity to be recovered through fees if the activity is contracted out to a third party provider. The Commission accepts this is so, presumably on the basis that the third party provider's fees would be a fully variable cost to MTF. MTF says this is absurd when the same costs and profit margin cannot be recovered when the activity is carried out in-house, even if the in-house option is more efficient, and results in overall lower costs and lower fees.

[103] We accept that, if the position is as outlined above, that would highlight one apparently anomalous outcome of a costs-focused approach to reasonableness of fees. But that is a criticism of the 2003 Act itself, not of the lower Courts' interpretation of it. In any event, we should not be taken to agree that a fee paid to a contractor would be reasonable in all circumstances, regardless of the level of the fee and the relationship it bears to the actual costs of providing the contracted-out service.

Default fees

[104] MTF argued it was absurd that the approach of the Courts below did not permit it to recover the estimated costs of bad debts through default fees. It said these costs were incurred only in connection with loans that are in default, so it was not unreasonable to recover them from a subset of defaulting debtors (those who temporarily default but then remedy the default), rather than via the interest rate charged to all debtors (including debtors who are not in default).

[105] Section 44(1)(a)(ii) referred to "a reasonable estimate of any loss incurred by the creditor as a result of the debtor's acts or omissions". As the Commission pointed out, it is hard to see how MTF's approach of spreading bad debts equally across all loans – whether for $1,000 or for $100,000 – can amount to "a reasonable estimate of loss" on any particular contract. We also agree with Toogood J that there is no compelling reason why temporary defaulters should pay costs attributable to other debtors who default permanently.[73] Temporary defaulters, who can be charged fees covering the cost of their own defaults, have no greater responsibility to pay for the costs involved with permanent defaulters that any other debtors.[74]

Treasury costs

[106] Another "absurdity" identified by MTF relates to treasury costs. It pointed out that the approach of the Courts below enables a proportion of the costs of banking, direct credit and debit facilities to be recovered through establishment fees, but not the treasury costs incurred in order to fund advances. It argued the treasury costs should be able to be recovered in the establishment fee because they were costs necessarily incurred in order to have money to lend – without them, no loan could be established.

[107] We agree with Toogood J that treasury costs constitute a general cost of the business of lending rather than particular costs associated with individual transactions.[75] There is no absurdity in allowing some banking and credit facility costs to be included in the calculation of the establishment fee but not for general treasury costs. The former are connected to the transaction for which the fee is charged. The latter are not connected to any particular activity, but are rather the costs of funding the overall business.

Criminal charges

[108] As mentioned earlier, Mr Goddard argued the uncertainty about the interpretation of ss 41–44 left a creditor in MTF's position in a difficult position

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73 At [112]–[115].

74 By definition, permanent defaulters will not pay these costs, given they are unable to remedy their default.

75 HC quantum judgment, above n 2, at [65]–[69].

given its exposure to criminal charges under s 103 of the 2003 Act.[76] As we acknowledged earlier, we see this as a valid criticism of the provisions relating to fees in the 2003 Act but it applies whatever interpretation of those provisions is adopted.

Did the Court of Appeal err?

[109] We now deal with the question on which leave was granted, in light of our conclusions in relation to the issues we have highlighted.

[110] Sections 41–44 must be interpreted in light of their purpose and in the context of the 2003 Act as a whole. We consider the purposes of consumer protection and comparability of credit arrangements, both clearly set out in s 3 of the 2003 Act, are more important purposes than the promotion of efficiency and innovation by credit providers and the facilitation of pricing flexibility, neither of which is mentioned in s 3. To the extent that efficiency, innovation and feasibility are relevant, they must be seen as applying only to the extent they can be applied consistently with the expressed purposes of consumer protection and comparability.

[111] The wording of ss 42 and 44 indicates a transaction-specific approach to the setting of fees. It is not permissible to take all operating costs (or virtually all) and allocate them to one fee or the other. The consequence of this is that many costs incurred by a credit provider will not be referable to particular credit transactions and will therefore have to be recovered in the interest rate.

[112] In applying ss 42 and 44 in order to determine whether a fee is reasonable in terms of s 41, the focus is on the costs incurred by the creditor in relation to the steps to which the fee relates (or the losses relating to a default). We do not accept MTF's argument that reasonableness is determined in "a broad common-sense manner" in which costs are simply one of many factors to consider. Nor do we agree that any costs that are beneficially related to an activity for which a fee is charged can be factored into the calculation of a reasonable fee.

[76] At [36] above.

[113] The transaction-specific nature of fees means that general overheads should not be recoverable. The reference to "reasonable costs" in s 42(a) and the requirement that a credit fee "reasonably compensates the creditor for … any cost" in s 44(1) both signal a need to ensure that fees are not set at a greater level than necessary to cover the transaction-specific costs incurred by the creditor. We agree with Toogood J (as did the Court of Appeal) that a helpful formulation in determining the reasonableness of a fee is to ask whether the cost is sufficiently close and relevant to the steps in the lending process to which the fee relates that it can reasonably be said it was incurred in relation to those steps. A similar approach should be adopted for default fees.

[114] As the statutory term is "reasonable", we do not think it is helpful to substitute an economic description of costs such as "variable" or "avoidable". That said, we think a fee based on the variable costs incurred in taking the steps for which the fee is charged is likely to be at, or below, the level that would be considered "reasonable" for the purposes of s 41 of the 2003 Act, assuming that the costs themselves are reasonable.

[115] Factors other than cost may be relevant in determining whether a fee is reasonable, but we agree with the Court of Appeal that non-cost factors are unlikely to render reasonable a fee that exceeds the level required to recover the reasonable costs incurred in taking the steps to which it relates.

[116] The "reasonableness" standard is imprecise and difficult to apply to particular situations. Fees have to be set in circumstances where the creditor may not have precise information on its costs and will not know how many transactions it will enter into during the period that the fee level is applied. Allowance has to be made for the situation where circumstances transpire that do not reflect those that the creditor predicted would apply. In applying the "reasonableness" standard lines have to be drawn. Reasonable minds may differ on where those lines should be drawn. That does not, however, mean that including costs on one side of the line and excluding those on the other leads to absurdities. We accept MTF's point that the calculation of fees on the basis of the lower Courts' approach is difficult for creditors and hard for the Disputes Tribunal and courts to apply. But the same would apply if

MTF's preferred approach were adopted. The criticism is really directed at the statutory regime itself, not to a particular approach to its application.

[117] Taking all these considerations into account, we do not consider that there is any error in the analysis of the Court of Appeal, which essentially adopted that of the High Court. If anything, the HC quantum judgment is generous to Sportzone and MTF. But the Commission did not seek to challenge it and we see no reason to interfere with it. We therefore answer the question on which leave was given: "No".

Result

[118] The appeal is dismissed.

Costs

[119] Sportzone and MTF must pay the Commission costs of $25,000 plus reasonable disbursements (to be determined by the Registrar in the absence of agreement between the parties). We certify for two counsel.

Solicitors:
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