IN THE SUPREME COURT OF NEW ZEALAND SC 40/2015

[2015] NZSC Trans 23

BETWEEN **SPORTZONE MOTORCYCLES LIMITED (in liquidation)**

MOTOR TRADE FINANCE LIMITED

Appellants

AND **COMMERCE COMMISSION**

Respondent

Hearing: 10 November 2015

11 November 2015

Coram: Elias CJ

William Young J

Glazebrook J

Arnold J

O'Regan J

Appearances: D J Goddard QC, I J Thain and C S Moody for the Appellants

S J Mills QC, K C Francis and P J Arnold for the Respondent

CIVIL APPEAL

MR GODDARD QC:

May it please the Court, I appear with my learned friends Mr Thain and Ms Moody for the appellants.

ELIAS CJ:

Yes, thank you, Mr Goddard.

MR MILLS QC:

May it please the Court, Mills for the respondent Commerce Commission with Mr Francis and Mr Arnold.

ELIAS CJ:

Thank you Mr Mills.

MR GODDARD QC:

Your Honour, the Court should have a road map that I've handed up through Madam Registrar. It's a longer than my normal two page road map for two reasons. The first is that after becoming so hopelessly lost in nested parentheses and Whakatū, I thought that perhaps more structure might help to keep me on track, and the second reason is that the last three pages deal with some factual issues which I'm hoping we won't need to descend into the detail of. I'm not proposing to do so in my principal submissions but if my learned friend wants to address those, then I'll deal briefly with them in reply. I thought it would be helpful, though, to provide detailed references.

ELIAS CJ:

Mr Goddard, the outline, of course, is useful and provides, as you say, a very useful structure. We have, of course, read the submissions and it won't be necessary for you to go through all of this will it?

MR GODDARD QC:

It won't be necessary to go through all of it in detail certainly.

ELIAS CJ:

No.

MR GODDARD QC:

I think it – what I'm proposing to do, as I hope the first page of – well, I'll start at the beginning. There are really two issues of principle for the Court. The section 41 prohibition in the Credit Contracts and Consumer Finance Act 2003, the CCCFA, as

it's often called, although the abbreviation is as long as the name when it comes to saying it.

ELIAS CJ:
It trips off the tongue perhaps a little easier.

MR GODDARD QC:
That might be it. It's hard to know which C words to get in which order otherwise.

So the CCCFA, section 41 prohibition prohibits, as the Court knows, including in a credit contract, a credit fee or a default fee that's unreasonable and, as I say in item 1, there are really two key issues of principle for the Court. I'm hoping not to get into fine-grained facts. The first is what factors are relevant when determining whether a fee is unreasonable and the second is what costs must be considered under the two mandatory relevant consideration provisions that are relevant here, section 42 and 44.

What I'm going to do is go through the legislation quite carefully. I'm going to look at the legislative history quite carefully because there are competing claims about the purpose of the legislation in the light of which it's said the reasonably open-textured language should be read. So, again, I think that's quite important. I think that that deserves a bit of time. For the rest I'm really going to identify key points but not go through the detail which, as Your Honour says, I have covered in my written submissions.

Those two issues of principle, although they're briefly stated, are very important to a large number of consumers, a large number of lenders, although formally the Court – this case is about some 39 transactions out of a hundred thousand entered into by MTF alone in the three year period to which the proceedings relate. Of course millions of transactions involving the provision of credit are entered into between retail lenders and consumers every year in New Zealand. We all carry one or more credit cards. We all enter into various other forms of credit contract, and making sure that the legislation achieves the balance between competing policy goals that it sets out to achieve is very important for the effective functioning of this market of this sector and, thus, for consumers and for those who provide services to them.

Really, without more ado, I thought I would dive into the Act. Both my submissions and the Commission's recite the familiar points about the need to interpret it having regard to its texts and I suppose I would add context, in particular the structure of the legislation, and its purpose, and one would hope also with a measure of common sense. One of the themes of my argument is going to be that one needs to test competing readings of the statute against their practical consequences. Consider some situations of frequent occurrence and ask what they will mean, how they will play out for consumers and for those who provide services to them on one or other reading of the legislation and especially in relation to open-textured legislation of this kind and especially in relation to legislation that governs a vast range of activities. I think it is important to do that testing.

The Court of Appeal was not all that enthusiastic about that approach. They referred to Mr Goddard's hypothetical scenarios or language to that effect but it's, of course, a very orthodox technique of statutory interpretation to say, "Well, what will it mean in these common situations if we interpret it one way or another?" and, here, it really is terribly important.

So the Act. The Act is in volume 1 of my bundle of authorities under tab 1. It's a reprint as at June last year because the Act was amended in a number of respects with effect from 6 June this year. As both parties confirmed in their leave submissions, the central issues raised by this appeal still arise in relation to the amended legislation, in particular, what was section 41(1) survives unchanged as now the only limb of section 41. There are some differences in relation to the following sections, in particular 44. In short my submission is that they can't help us to ascertain what was or was not prohibited in 2005 to 2007, what circumstances exposed the appellants to civil liability and potentially criminal liability.

There are two possibilities with this subsequent legislation. One is that looking at it will tell us nothing about the meaning of the legislation in force at the relevant time in which case it's a waste of time. The other is that it does affect the way the Court reads the prohibitions. If that were so then, as a matter of principle, it ought not to be taken into account because that would alter the nature of a criminal prohibition retrospectively and that can't, as a matter of principle, be right.

ELIAS CJ:

But you're going to start with the legislation as it was in force?

MR GODDARD QC:
And I'm going to ignore the amendments for that reason.

ELIAS CJ:
Yes.

MR GODDARD QC:
I just don't think they're helpful. But I just thought I should explain why I'm giving the Court something other than the current version of the Act and it's – and both the practicality because it's the version that was in force at the time of the relevant conduct and that it was considered by the Courts below and also because in my submission as a matter of principle, it would be inappropriate to read it in light of subsequent amendments.

Coming, then, to the Act, and beginning on page 8, the preliminary provisions, the purposes of the Act (a) of course to protect the interests of consumers in connection with credit contracts, the relevant form of contract here. And it's of course uncontroversial that this is consumer protection legislation. The contested territory is what reading of the Act best protects the interest of consumers, (b) to provide for disclosure of adequate information to consumers under credit contracts and that disclosure is for three purposes, to enable consumers to be able to distinguish between competing credit arrangements, to enable consumers to be informed of the terms before they become irrevocably committed to the contracts, and to enable consumers to monitor performance of consumer credit contracts, and (c) to provide rules about interest charges, fees and payments in relation to consumer credit contracts.

I'll come back to this later but it's perhaps just worth noting here the way that the framers of the legislation thought about the rules on fees. They are addressed in a separate limb from the disclosure limb. It's not suggested that the rules about fees are part of the disclosure regime as such, and they're linked to the provision of rules about interest charges and that was a link that was explicitly drawn in the development of the legislation. There are some rules about the way in which interest is expressed and applied in this Act and one of the key concerns in relation to fees was that they not be used to do an end run around those interest rules. It's not the only concern, obviously.

ELIAS CJ:
And the disclosure regime.

MR GODDARD QC:
And the disclosure regime so there needs to be absolute transparency in terms of what each of the fees is and I'll go to the disclosure rules. They're important. So you need to disclose them in advance and you are then obviously stuck with what you've disclosed. That provides the information. In relation to fees, they must not be unreasonable and just why that standard was imposed and what it means we're going to spend a bit of time on later. But it's wrong to – no, I'll deal with that later. I'm at risk of getting myself off track. I'll continue reading through the legislation.

ELIAS CJ:
One of the things I noticed and I don't think anyone's said anything about is that there's very strict time limits for opening up unreasonable fees. It's just a year, isn't it?

MR GODDARD QC:
The way that those worked within a year of the fee being charged you had three years within the inclusion of the provision in a contract is the way it's been – so the breach of 41 is to include it in the contract. If you include it in the contract you've got three years to bring a claim under the general provisions of the exceptions 95 and 96. In addition, even if you've missed the boat on that because, for example, the contract has a life longer than three years as most mortgages, residential mortgage lending would, within a year of the fee being charged you could make an application under section 41 as the Act then stood. That's changed. Now you're just in the 94 space but at the time that was the way it worked and then, of course, you've got the oppression provision separately which provide yet another timeframe within three years, effectively, of the last payment, I think, under the contract.

ELIAS CJ:
Yes. I was just wondering in that statutory scheme whether there is any argument either way about perhaps you might tuck it away and think about it in relation to how the provisions should be interpreted because it is a quick – and maybe therefore not a particularly fine grained approach.

MR GODDARD QC:

I will be making the submission that a prohibition on unreasonable fees should be something that a creditor can sensibly identify as a potential problem and make a complaint about or bring before a disputes tribunal without first hiring a forensic accountant.

GLAZEBROOK:

Do you mean debtor?

O'REGAN J:

A debtor, not a creditor.

MR GODDARD QC:

A debtor, I'm sorry. That a debtor should be able to identify as a potential issue, at least, and raise and it should in most cases be able to be dealt with.

ELIAS CJ:

Well, it may go the other way. It may suggest that these things asked of judgments which are in part matters of pressure …

MR GODDARD QC:

That's my submission, yes.

ELIAS CJ:

I'm not sure that it's necessarily in your favour but however.

MR GODDARD QC:

I think it is, Your Honour. When one asks what one would expect to inform that impression and whether that it should be the case that, for example, the permitted fee moves around from year to year to a level of, you know, sense within the dollar precision depending on precise budgeting rather than saying, for example, impressionistically this is at a level which doesn't seem outrageous, $3 a month for administration. It's within the range of what people are doing in the market. There are obvious costs which gets you part of the way there. Is it unreasonable to round it up to $3? No. And you don't have to charge $1.75 one year, $2.03 the next year and whatever. So that's the sort of issue.

WILLIAM YOUNG J:

Why push the margin? Why not simply say, crikey, it's a criminal offence to charge more than is reasonable. Let's be really conservative about this and just stick to variable costs, what would be the problem with that?

MR GODDARD QC:

The problem with that would – well, there'd be two problems. The first is that you'd end up with some peculiar differences in fee structures depending on internal business decisions that are a matter of complete indifference to debtors, so that's a funny intention to attribute to Parliament. The second – and this, I think, will become very clear when we go through the pre-legislative material – is that the CCCFA responds to an awareness that credit products were becoming more sophisticated and as a result more complex and there was a positive desire to facilitate innovation in design and in charging structures and while of course one – so put it another way, one thing that was possibly considered in the course of the amendments, Your Honour, was to prohibit charging fees, the most conservative version of what Your Honour has just suggested. Let's not have fees at all. Let's just have an interest rate. That was rejected as being in the interests of consumers. The policy process explicitly considered that and said, "No, we don't think that that's a good thing for consumers because it inhibits flexibility. It inhibits innovation," and the same is true of adopting the approach Your Honour has suggested.

GLAZEBROOK J:

What is the innovation here? What is suggested the innovation is here?

MR GODDARD QC:

In the structuring of credit products?

GLAZEBROOK J:

No, no, in this particular case. What's the innovation?

MR GODDARD QC:

The products that are offered here are supported by reasonably innovative technology in relation to the speed of approval and mechanisms for approval of lending, for example. The evidence looks at the computerisation of the lending process that was developed at the same time as this.

GLAZEBROOK J:

What’s the reason that’s not just put into the interest rate? Was the innovation having fees rather than put in the interest rate here?

MR GODDARD QC:

Having fees is not an innovation. Having flexible charging structures that target costs more closely to those that cause them is a form of innovation in the market which would broadly be expected to be efficient in the absence of concerns about information asymmetry or exploitation of market power and I need to come back to the extent to which those are relevant because the Commission makes some submissions about them. But broadly speaking, the idea that you target the costing of a product to the person or activity or group that causes the cost is a positive element of flexibility or innovation which should enhance access to credit, should reduce costs, for example, to borrowers who perform.

So one of the issues we’re going to come to, and I’m –

GLAZEBROOK J:

But don’t they lump all of the costs to do with absolutely everything onto individual borrowers rather than the specifically related costs? So I don't understand that rationale you’ve just put.

MR GODDARD QC:

No, different costs are put into different fees in a way which is designed to reflect the costs that are incurred in order to undertake the relevant activity, in order to provide the relevant service. And if you can attribute costs, more appropriately to the causes of those costs, then other things being equal, you’d expect to see better provision of credit for consumers as well as reduced costs for lenders, bearing in mind that in a competitive market ultimately you’d expect those efficiencies, those savings to be passed on.

O’REGAN J:

But there’s no competitive pressure here because MTF just worked out its costs and said, “We’re going to charge them all.” It didn’t say, “We will only do this if the market lets us,” did it?

MR GODDARD QC:

No, there is competitive pressure, Your Honour, because vehicle retailers have the choice of a range of providers of finance to their customers. Their interest is in selling as many vehicles as they can, and in order to do that the need to offer credit to their consumers because a number of people who can walk in and write a cheque, I suppose even that's a little bit old fashioned of me nowadays, for the vehicle are limited.

O'REGAN J:

But they have exclusive arrangements with MTF don't they, the dealers?

MR GODDARD QC:

For a period and only because they have chosen to enter into those. If we look Sportzone, Mr Holtham's evidence was that they used to use Farmers Finance, I think, Farmers Mutual Finance but they went to MTF instead. And at the point where you're competing to deliver the service to the retailers in particular, it's very much in your interest that what you're providing is an attractive package that keeps the cost of buying the vehicle down so that they can sell more vehicles. And the retailers, in fact, operated, in my submission, as reasonably sophisticated intermediaries and are the point at which the competition is at its most intense.

O'REGAN J:

But that doesn't seem to reflect in MTF's planning for this regime. It was all just simply about let's take all our costs and allocate them to fees. It wasn't saying, "And if we do that the market will think we're fantastic." It was basically saying, "We can do what we like."

MR GODDARD QC:

I do deal with some of these factual issues in my annexure and I'll come to them. I need to – just to clear up one point. Initially it wasn't all costs. It was about 73% of costs. A substantial proportion of costs were not included in fees, and there's an annexure to Mr Todd's evidence which sets those out, annexure A, and I've got references to that in there.

So it's wrong to suggest, as the Commission does, that this was a full cost absorption model. A decision was made – now there's room for argument about which costs should be in, which costs should be out, of course, but it's wrong to suggest that

there was a blind blanket all our costs, other than the interest costs of funds will go into fees.

Second, it's clear that MTF put considerable energy into attracting business from retailers. Indeed, one of the contested areas of cost is the marketing to dealers and things like the floor plan costs which are a way of incentivising dealers to deal with MTF rather than other finance providers and that MTF is operating in a competitive market in that sense is, I think, reasonably uncontroversial.

Another point just to bear in mind, but I won't go too far into it because it's beginning to stray into the issue on which leave was sought but declined, is that if MTF had no relationship with the dealers, if it was simply a finance company providing back to back lending to retailers at a commercial level and the retailers were then on lending, and perhaps instead of individual contracts being assigned by way of security there was simply a general security agreement under the PPSA, overall the assets of the dealer, then in those circumstances it would have been very clear that first the credit provided by MTF to the dealer was not subject to part 2 because it's not a consumer credit contract and, second, that in the dealings between the dealer and the consumer, the charges from MTF were charges that were being passed on. They were fully variable to the dealer and no question about –

GLAZEBROOK J:
Well, don't assume that the Court is necessarily - all members of the Court would necessarily be in agreement with that and in any event it's not before us.

MR GODDARD QC:
I'm going to come to the treatment of variable costs and outsourcing versus in house provision later because that's relevant to the assessment of reasonableness but it is, I think, helpful to bear in mind that the service provided by MTF is provided in a competitive non-consumer market and in a context where with different contractual relationships between the parties which have no obvious bearing on fee setting. The same scrutiny, in my submission, wouldn't apply and I'll deal with that later.

ARNOLD J:
Could I just ask a point arising out of your answer to Justice O'Regan when you said, "In fact it was only 73% of the costs?" I understood your position to be, and I'm just looking at 5.31 of your submissions that it was unreasonable – costs that it is

unreasonable to take into account costs relating to the time value of money, costs recovered through other fees and charges or costs wholly unrelated to the matter or activity. Now is there another category in there or are you saying that the 27% that wasn't recovered is time value of money or things wholly unrelated?

MR GODDARD QC:
No, I'm not counting time value of money. It's 27% of costs other than time value of money that were not recovered through fees.

ARNOLD J:
So where do they fit into your (a), (b) and (c)?

MR GODDARD QC:
And by definition they're not in (c).

ELIAS CJ:
They're able to be charged on your argument aren't they? That's just a question of choice.

MR GODDARD QC:
In fact the position that was – as it evolved by the time of the quantum hearing and the quantum judgment was that it was accepted that some of the things that had been included in some of the fees probably fell within (b) and were out. They were unrelated but that some of the things that Sportzone hadn't sought to recover were not, in fact, wholly unrelated and could've been included. So there's still a percentage that's out but it's not, doesn't mesh perfectly to the categories that MTF back in 2005 sought to exclude.

ELIAS CJ:
But on the assumption that you made that this was all cost recovery but you are not recovering 27% of the costs leave aside whether they really were costs which is what you're talking about in accepting. Surely it is simply a matter of choice on your argument whether you go for the full 100% of the cost.

MR GODDARD QC:
Not if you – you've got to decide what fees you're going to charge and there's inevitably going to be a description of those fees. Some are driven, some

descriptions are driven by the Act, others are not. Establishment fees are a defined term and then you've got other credit fees. Once you say to a consumer that you are charging a fee in respect of certain matter or a certain activity or a certain service, what the Act requires is that there be a reasonable relationship between what you charge for that activity and the activity service, and in deciding whether there's a reasonable relationship you need to take into account the costs incurred in carrying out that matter. So, for a creditor who doesn't, who charges only a very limited range of fees, there's going to be a range of activities, a range of costs associated with those activities, which don't come within any fee. One of, if you charge a wider range of fees for a wider range of specific matters, consider administration of the loan on an ongoing basis, which is something that some creditors charge for, others don't separately charge for. If you don't have an ongoing administration fee, then obviously costs that relate solely to the ongoing administration of loans that do not relate to its establishment cannot be charged as part of the establishment fee, and costs that relate solely to defaults can't be charged as part of some other fee described in some way.

One – so there is that limit, that there is that limit, that there should be a reasonable relationship between the matter that the fee is described as relating to and the fee charged informed by the costs that contribute to that matter, that contribute to that activity. It's hard to imagine that there could be a situation in which every dollar of cost incurred other than interest charges by a lender is recovered through fees, but if you had a model in which the creditor effectively was just a portal on the web and contracted out almost every aspect of its activities, and charged fees in relation to each of those steps, you might get close. The whole point is that you've got general standards, because the range of ways in which credit can be provided is so diverse.

ELIAS CJ:
I still don't – sorry.

ARNOLD J:
Well I must – sorry, for myself, I hadn't understood that that was the effect of your argument. I thought the effect of your argument was that these three categories of cost that you've identified at 5.31 were costs that were legitimately taken out, but everything else was in, and if you'd had a single, and enterprise which thus just does one thing, in this case, lending, not a multi-product firm with a whole lot of different activities, then, as I understood it, everything was referable, ultimately, back to the

various activities, and so the managing director becomes part of the costs of that become part of the establishment fee.

MR GODDARD QC:

I think, where the key point, and a point which, perhaps, isn't clear enough in 5.31, is that this is a test to be applied fee by fee, and so first of all there's a decision about whether or not to charge fees, and if so, what types of fee. Having decided to charge a particular type of fee, one must then apply this test; and the interest costs always out, cost you've recovered somewhere else, obviously always out.

ARNOLD J:

Yes.

MR GODDARD QC:

That's easy.

ARNOLD J:

Yes.

MR GODDARD QC:

The extent to which (b) bites depends on what the matter or activity in respect of which the fee is charged is; and if you're charging something a very specific fee, an administration fee separate from establishment and default, then obviously there's a huge range of costs that it would be completely inappropriate to take into account all costs associated with defaults, for example, because they have nothing to do with ongoing administration.

ARNOLD J:

Well, that comes into –

MR GODDARD QC:

Even if you don't charge a default fee, no.

ARNOLD J:

Oh, I see.

MR GODDARD QC:

So, you see, even if it's, even if there's no default fee, Your Honour, so it's not in (c).

ARNOLD J:

So, in reality, the example you give there's not a great one, because you've got a lending activity and the example you give is Sportzone recovering the costs of operating its motorcycle maintenance workshop. Well, that's an obvious, but you're talking about something, to use your language, much more fine grained than that.

MR GODDARD QC:

Something more constraining than that, something which ensures that fees, first, are not interest in drag, second, don't involve an element of double-counting, but third, critically, bear a reasonable relationship to what you tell the consumer you are charging the fee for and that, in my submission, is what 41 is all about. Does the fee bear a reasonable relationship to what you tell the consumer the fee is for? And that's why we see in 45, which deals with third party fees, if you tell the consumer that you're passing on a fee from a third party, it must just be the fee from the third party.

ARNOLD J:

Yes.

MR GODDARD QC:

But if you tell a consumer that you're charging a fee for some other matter, be it ongoing administration, be it establishment, be it default, then that fee must bear a reasonable relationship to the matter to which the fee is said to relate. Now –

GLAZEBROOK J:

You're going to show us where this is in the legislation, are you?

MR GODDARD QC:

Of course, but I've been –

GLAZEBROOK J:

Yes. I know, I understand that. It's just I didn't think the legislation was quite so fine-grained, that was all.

MR GODDARD QC:

Well, again, it's not my submission that it's that fine-grained, it's my submission that the legislation poses a reasonableness test and that we are doing what the Courts do whenever asked to assess whether something is reasonable, which is to look at all factors that shed light on that reasonableness.

GLAZEBROOK J:

Sorry, I meant the splitting of the fees into these different categories that you're talking about. I mean, certainly establishment and default.

MR GODDARD QC:

Well, those are expressly identified as particular types of fee.

GLAZEBROOK J:

I know, I just don't know where the others are expressly identified, because I –

ELIAS CJ:

They're not, are they, but, but –

MR GODDARD QC:

Then there's a broad category of credit fees.

ELIAS CJ:

Yes, but, but on your approach –

MR GODDARD QC:

And your –

ELIAS CJ:

It's just a question of how you define it, how the creditor defines it and slices it; and, you know, it becomes self-defining by the creditor, really, doesn't it?

MR GODDARD QC:

And, to a large extent, that is what was intended and I'm going to look, first of all, at the structure of the legislation and then at the legislative history, to show that the alternative, limiting the types of fee that could be charged, limiting the amounts of fee

that could be charged, were all considered and explicitly rejected as inhibiting flexibility and inhibiting innovation in the credit market.

O'REGAN J:

There's nothing about innovation in the purposes section, though, is there?

MR GODDARD QC:

No, the interests of consumers is of course, and I don't think this is controversial, the long-term interest of consumers, and in every other sphere where that concept is invoked, it's well established.

O'REGAN J:

Well, if it's, if it's as important as you say it is, you would've expected it to be in section 3, wouldn't you?

MR GODDARD QC:

Well, I –

O'REGAN J:

I mean it, section 3 is about consumer protection and controlling fees, it's not about innovation.

MR GODDARD QC:

Well, the interests of consumers in connection with credit contracts are protected by ensuring a vibrant and competitive market with a wide range of products.

O'REGAN J:

Well, they're not, they're not, but they're not by having higher fees, are they?

MR GODDARD QC:

They're not by having a high total cost of credit, but how the cost of credit is carved up is a matter which is, does provide scope for, you know, flexibility and innovation and that was always the intention.

O'REGAN J:

I mean the only, the only thing here is we've got, it says, "Provide rules about interest charges, fees and payments," it doesn't say anything about promoting variations of

that, so, I mean, in fact, I would've thought the, the overall scheme of the legislation is that you don't want variation, because you want people to be – to compare apples with apples.

MR GODDARD QC:
That was considered as an approach and rejected as undesirable and unworkable and I think probably, and in my submission that's right and the scheme of the legislation reflects that. The – we followed an Australian model in our approach to disclosure and our approach to fees, broadly speaking, which is different from the approach that was adopted in most other countries at that time and we see that being explicitly canvassed in the policy work leading up to the legislation and that was done because of a recognition, in my submission, absolutely right, that trying to limit the number or amount of fees inhibited the development of products that were desirable to some consumers. It would mean that some consumers were not served at an optimal cost and that the apparent gain in comparability achieved by shoving everything into a single head – interest rate, or even requiring the calculation of what we used to have under the Credit Contracts Act 1981, the annual finance rate, the AFR, was more illusory than real and there's a very good, very thoughtful analysis in one of the policy papers about why that doesn't work, why it's more likely to mislead than to help, and that's why we followed Australia down what was then a very novel path of moving away from AFR disclosure, which had been part of consumer credit protection since the earliest development of that in the United States in the 1960s towards a requirement to disclose all the elements of the contract, not to try and bundle them up into a single number, recognising that that came at some cost in terms of comparability but that that was a trade-off that was acceptable, indeed, desirable, in order to promote a wider range of products being offered to consumers.

I think one has to remember what this was reacting to in terms of the Credit Contracts Act and that's why the history is important and what was seen as the problems with that regime and what changes were sought, and also to some extent that this regime was developed in the early 2000s at a time of greater optimism about the benefits to consumers of flexible and innovative credit products than perhaps is the case post 2008 and it's wrong to try to understand this 2003 legislation with 2008 spectacles. Of course legislation is always speaking but at the same time one does need to give full effect to the purpose at the time which was weighted as much on access to products and differently-priced products to meet different needs and different preferences.

O'REGAN J:

But doesn't the benefit of innovation apply just as much to the Commission's approach as yours? I mean, it's just – you're just saying it's a wider range of costs that can be brought into the pond but I mean on the Commission view you can choose whether you allocate these things to fees or interest rates but they're just saying the reasonable standard has a lower ceiling than you say it has. So within that boundary, basically you're both singing out of the same hymnbook, aren't you?

MR GODDARD QC:

There's certainly some overlap in the two approaches. It would be odd if there weren't. The question is how – it's partly how low the ceiling is but also importantly it's what purpose is served by the ceiling and therefore what you take into account when you work out whether you're within the ceiling or not and in a nutshell the Commission says having a lower ceiling improves comparability. That's the central argument. They're not saying it will produce necessarily lower cost to consumers because they recognise inevitably that costs that are not recovered will be recovered elsewhere. Obviously there are issues about the extent to which markets are competitive, the extent to which consumers make informed decisions and I need to come back to the detail but if you look at someone like MTF whose interest rate was comfortably below its main competitors there could have been a higher interest rate and lower fees. The question then becomes, if it's not that you pay less overall. Sorry, the other thing I should say that there was some evidence below that the main focus of most consumers is on the weekly or monthly payment they're going to be making, which – and a lot of the advertising that's in the bundle focuses very much on the X dollars per week for your new motorbike which bundles together a lot of these charges but obviously default fees because you can't predict.

O'REGAN J:

The establishment fee, is that paid upfront or over the term of the loan?

MR GODDARD QC:

That's paid upfront and included in the principal.

O'REGAN J:

So it's the maintenance fees that get paid during the term?

MR GODDARD QC:

Yes. But often the establishment fee is included in the amount advanced. That's the normal arrangement, so it then gets factored into the weekly or monthly payments because you're recovering that as well as the capital cost of the vehicle in question.

So that figure, how much you pay per week or per month, includes the interest – takes into account interest, takes into account establishment fees because they're being recovered through that. It takes into account ongoing administration fees. It doesn't, obviously, take into account default fees because the figure is not predicted on the basis that the person is expected to default but what that means is that you have four products that involve a fixed interest rate and a reasonably short term, a predictable weekly payment which is a good comparator for consumers.

One of the problems we'll see when we come back to policy is the sheer range of products we're talking about here. If you've got variable interest rates, you can't come up with a weekly amount which is constant across it. If you have a flexible credit product, be it a credit card or be it a revolving credit facility secured by your mortgage like many of us are dependent on, then again you can't predict weekly or monthly payments, because it all depends how much you use the facility; and one of the key concerns that drove a move away from AFRs, annual finance rates, that drove a move away from any attempt to come up with a single figure representing a cost of credit was recognition that a lot of modern products cannot meaningfully be described in that way and you can't compare them. I mean, if you're trying to compare buying a motorcycle from Sportzone with MTF finance or buying it on your credit card if your limit's high enough, or if you've got the headroom in your revolving credit facility, buying it on that, the complexity is real, the complexity is not imaginary, and what the policy process recognised was that if there is inherent complexity because services work in different ways, then actually it's misleading, it's unhelpful to consumers to try and pay for that over.

You know, there's that famous Einstein saying that a theory should be as simple as possible, but no simpler; because if you oversimplify it becomes misleading. The same is true of disclosure. Disclosure should be as simple as possible, but no simpler, and if the complexity is inherent in the market because of the range of products, rather than manufactured, then, and if you consider that prohibiting aspects of that complexity is contrary to the interests of consumers, which was a consistent theme throughout the policy process, then where your taken is, okay, we accept that

there will be a range of different ways of charging, interest rates which may be fixed or variable, interest rates which may vary for different amounts of borrowing, interest rates which may be fixed for a period and then float, holiday periods on interest, very common; all of those things – and there may be fees of different kinds, some creditors may not charge any, others will, they'll have different structures. We can't shoehorn those either into a single structure or into a single disclosure number, so what we will do is ensure that the different elements of the transaction are disclosed so that there is as much transparency, as much comparability, as can reasonably be expected, so, and this is a point I'm going to come back to, but the existence of a trade-off was recognised, that phrase trade-off occurs more times than I had been able to count, I ran out of fingers in the policy process. There is a trade-off between flexibility, innovation ensuring that different categories of consumers are served by different products, and ease of comparison, and the legislation strikes a balance, and I think one of the traps that both the Commission's submissions and, to be fair, my submissions fall into, is emphasising one limb of the trade-off to the exclusion of the other and, of course, the whole point of a trade-off is that you haven't just got one objective, you've got two, and you're trying to find a path between them and the legislation, in my submission, was intended to walk a path that balanced those objectives and can be read as doing that in a way which works sensibly, but that's not the result produced by the readings below.

ARNOLD J:

It does rather suggest that the Court should really focus on the language used. I mean, if, if there are a range of trade-offs, I mean, a lot of the submissions, in a sense, are an argument about policy, but, I mean, our task, really, at the Court, is to, is to try and interpret what is here, understanding the purpose and all the rest of it, but there, as you say, are a range of policy choices that could be made.

MR GODDARD QC:

And, in a way, my core submission is that where those policy choices led the legislature was to prescribe a reasonably open texture standard, reasonableness, and to leave it to be applied in a sensible way on a case by case basis, requiring regard to be had to certain costs, but only as one mandatory relevant consideration, not as an exclusive consideration, because of the potential that was recognised for other factors to be important to that reasonableness assessment in each case, and we see that come through, so again, I think that's consistent with my submission that

the Commission's approach, the approach of the Courts below, have tried to shoehorn into too precise a box a more broad, evaluative approach.

ARNOLD J:

Well, look at, look at the definition of establishment fees. It says it means fees or charges payable under the contract that relate to these various four things. Now, on your view of it, and it excludes fees or charges to the extent that they relate to an optional service.

MR GODDARD QC:

Yes.

ARNOLD J:

Now, and then when you go to section 44 or whatever it is, you get the same four things mentioned. Is it –

MR GODDARD QC:

42, Your Honour, sorry, yes.

ARNOLD J:

42. Now your argument is, well, they're simply there to get the Court to think about them, but there are a range of other costs that come into this equation through the language of relating to or in connection with, through this broad language.

MR GODDARD QC:

In relation to establishment fees, I accept that something which is described as an establishment fee must, in the statutory framework, relate to the costs in connection with those four matters, but the question then is what does it mean for a fee to relate to costs? Does it mean "equal", or does it mean "is designed to recover over the medium to long term", and more importantly, which costs are we talking about, because the way that the Courts below have approached this, in terms of talking about closely connected is to start with the concept of variable cost on a per transaction basis, and then accept that some other costs will come in which is very much variable costs and then a relaxation of that to allow some fixed costs, especially if they're direct fixed costs like IT depreciation, like premises. So the question becomes, well, a reasonable creditor setting an establishment fee which is designed to relate to these categories of cost, what will they take into account? And

there are a range of points at which the analysis might be seen to stop in relation to costs. We've then got to get to other factors and the extent to which they appear on it, but in relation to costs the interconnection with language is –

ARNOLD J:
But it can't mean anything so the managing director's costs, how are they in connect with these specific activities?

MR GODDARD QC:
So there are a range of ways that you can think about the connection between an activity and costs. There's the variable cost of doing just one of those activities. That can't be what was intended here, especially when one looks at provision for averaging, and the Courts below haven't said that it was and although some of the Commission's experts proceeded on that basis the Commission was never quite so absolute in the conceptual submissions based on that.

GLAZEBROOK J:
Well, the language actually does say in relation to the application for credit. It doesn't say in relation to applications for credit averaged out over everybody and taking into account everything that might possibly be associated with it.

MR GODDARD QC:
We get the averaging language explicitly in section 42.

GLAZEBROOK J:
I understand that. I'm talking about the definition of establishment fees.

MR GODDARD QC:
Let me – the question of –

ELIAS CJ:
Well, it's important to your argument that it's not a definition.

MR GODDARD QC:
It's a definition of the fees and it's the only type of fee that's defined by reference to costs. None of the others are. It may be –

ELIAS CJ:

What about the word “fee”, though?

MR GODDARD QC:

Well, again…

ELIAS CJ:

Fees are charged for services.

MR GODDARD QC:

So when I send a bill to a client, for example, and I say “my fee”, I don’t think that they expect that I can trace that back to particular outgoings. There are concepts of opportunity cost, for example, which become important, which is economic cost, not an accounting cost which I think everyone accepts raises a different set of issues here.

ELIAS CJ:

What is the service provided?

MR GODDARD QC:

By me, establishment. I hope that wasn’t what Your Honour was wondering.

ELIAS CJ:

It’s only…

MR GODDARD QC:

The service provided is the service of providing credit to that person.

ELIAS CJ:

Well, no, it’s the service of establishing the facility.

MR GODDARD QC:

So it’s uncontroversial that that includes the costs of considering the application, deciding whether or not to advance the credit, deciding what the pricing should be in the light of the risk analysis, arranging – making practical arrangements to advance the credit. There is a controversy, a disagreement about whether included in the concept of advancing the credit is included obtaining the funds to advance. That’s

the significant dispute about the cost area, the cost centre, that's included here and I'll come to that later.

But I just want to come back to Your Honour Justice Arnold's question about what it means to talk about costs in connection with these matters or any other matter. You've got at one extreme the variable cost of doing it once. Then you've got the variable cost of engaging in such activities for a one year period which was an approach that was canvassed extensively in evidence. Then you've got the familiar point to those of us who spend time with economists that all costs are variable in the long run and in my submission that's actually a helpful insight here because if one asks oneself what are the avoidable costs of not undertaking the activity yourself then I think that's a pretty good pointer to a set of costs that's obviously incurred in connection with that activity.

If we're talking about the activity of processing and considering credit applications, there are a number of people who offer that service to people who have capital but don't have that expertise. If you are doing it yourself at present and you decide to contract that out, what costs will you save? Who can you get rid of? How much can you drop your premises? Your avoidable costs of that step, it seemed to me, must all be described as costs incurred in connection with that activity and yet that's a broader category already than the one that was approved below because it certainly included not only the frontline staff who are processing those and ringing Baycorp and doing whatever they do but also the people who train them. You don't need trainers if you don't have the people. The people who supervise and manage them, you don't need them, the cost of all the training and premises and equipment.

But then the question comes to what extent is it proper to describe a proportion of fixed and common costs like managing director costs as costs incurred in connection with that activity? In my submission, management costs in relation to a company that engages in a range of activities are incurred in connection with the full range of those activities. They're what makes it possible. It's an orchestra without a conductor will not play something that's recognisably a tune. So the cost of having a conductor is a cost incurred in connection with making sure you have a functioning string section and horns and everything. Similarly in this context, the management costs are included in connection with all those activities. Now, it would be unreasonable to arbitrarily lump all of those into one box to the exclusion of others to which they can also be said to be connected, to which they also relate.

So what is reasonable is to do what most firms in most service industries do, and to do what regulated industries are consistently permitted to do in consumer protection regulation administered by the commission, which is to recover a fair allocation of those head office costs, those management costs, from each relevant activity. So, connecting with an electricity lines business, or a business that has electricity lines that are regulated, and other un-regulated businesses. When you come to apply part 4 of the Commerce Act, and you look at your cost building blocks, you will allow a reasonable allocation of fixed and common costs of management into the regulated activity and some into the un-regulated; you can't lump it all into the regulated, but nor are you expected to cover it all out of the unregulated. Exactly the same concepts come to bear when you ask whether you can reasonably regard some share of management costs, some share of head office costs, as incurred in connection with this, and the Commission itself has held that view at some times.

Now, again, I'll come back to this and I absolutely accept what my friend says about the fact that draft guidelines are just that, published by the Commission, finding in any way interpretively, but the Commission is unlikely to take a stance as it tries to figure out what this means, that is outside the range of reasonable understandings of what in connection with means, and they have struggled to understand this and they have, at times, suggested, in my submission quite rightly, that it's reasonable to regard a share of head office costs of that kind as incurred in connection with each of the activities to which those costs contribute.

ARNOLD J:
But, of course, that adds greatly to the complexity of the analysis. I mean, the beauty of a variable cost approach is that it's reasonably simple and straight forward to operate and if the same standard is applied to everybody in relation to establishment fees, then the competition occurs in the guise of the interest rate, just change the, changes the locus.

MR GODDARD QC:
Two things about that; three things, maybe. First, the, there is additional complexity, but that comes back to the as simple as possible, but no simpler. If that simplicity comes at some other cost in terms of policy objectives, then it's not necessary, desirable, and in my submission, the balance struck lies elsewhere. Second, Your Honour's suggestion that if you drive it down to variable costs then you've got a

measure of commonality and competition can compare – can occur on the headline interest rate, doesn't work for a number of practical reasons that were looked at in the policy process, and also emerged from the evidence in this case, which is that people's variable costs are very different, of these activities, depending on the business systems and business methods. There are still people out there, and certainly there were in the period we're concerned with, 2004 and 2005, that have a lot of people sitting at desks with pens and picking up the phone to do credit checks.

Then, you've got other people who make large capital investments in order to automate that. So, variable costs are very different, which means that you're going to have very different fees, even if you only allow recovery of variable cost, it's wrong to assume that they will all be –

ARNOLD J:
Well, the basic problem, I mean, I don't see any problem with that. Somebody who's automated and becomes very efficient has a low fee and, presumably, have a lower interest rate, there in a strong, competitive position. I thought your point was that looking at it in that way actually creates a disincentive to investment for improving your systems, because –

MR GODDARD QC:
And it can –

ARNOLD J:
The variable cost drops and you don't recover.

MR GODDARD QC:
And I'll come back to that.

ARNOLD J:
Yes.

MR GODDARD QC:
But, if you imagine two lenders with the same cost of funds and otherwise the same cost structures and then one of them automates and they're making a large capital investment, on the Commission's approach, what they have to do is drop their fee in respect of that activity down to something at or, on Your Honour's – and the Court

probably perhaps slightly above, because you put a few other things in, variable cost, and the capital cost has to be recovered through the interest rate, so that goes up, and, in fact, the borrower may well be, if they are just recovering normal profits, better off, but the information, because it requires a trade-off between a fixed fee and an interest rate which continues over time, a one-off fixed fee is hard to do, and that's the point that is well identified in the policy process. These comparisons just are intrinsically difficult and is it desirable, was it a goal of this legislation, to focus competition just on a headline interest rate? The answer, unequivocally, is no. it was recognised that that was an aspiration that was neither practically achievable nor, in fact, desirable, because it disadvantaged some – it created the impre – even if you could apply it to some products, it would create the impression that they were less advantageous for consumers than was, in fact, the case.

ELIAS CJ:

You have to convince us of that on the structure and scheme of the Act.

MR GODDARD QC:

Yes.

ELIAS CJ:

Perhaps augmented by the legislative history, and it may be that you should really go to that.

MR GODDARD QC:

Yes, I think I was, and I was bouncing off some questions –

ELIAS CJ:

Yes.

MR GODDARD QC:

In relation to section 5 which was as far as we've got.

ELIAS CJ:

But I'm flagging that, I'm flagging that I'm not sure that the, that the legislation, the scheme of the legislation isn't exactly that, that you, you recover your costs in the margin you set in your interest rate.

MR GODDARD QC:

But which cost, Your Honour, that's what –

ELIAS CJ:

Well, except those, that are clearly referable to the sort of services that are identified in the scheme of the legislation.

MR GODDARD QC:

But even if I were only to persuade the Court that the right test is the avoidable cost test that I touched on a moment ago, that when you're talking about costs in connection with processing and considering applications, you have to look at all the avoidable costs of that activity; the costs that you wouldn't incur if you ceased to do that and contracted it out. Then, the result is that the principles applied below is wrong and it will need to be re-applied to the fine-grained cost, and I should say at once that I am not anticipating that this Court will delve into the minutiae of that. My working assumption is that if the Court is satisfied that the approach adopted below was, in some respect, incorrect, it will, really, need to go back to the High Court to apply the correct approach to the very large quantity of factual evidence and all the gruesome spreadsheets.

But, what, in my submission, must be the case when we look at the scheme, is that too-narrow an approach has been taken to identifying the costs that are mandatory, relevant considerations under 42 and 44 and, in addition, I say there are other matters which should have been considered, which were not, but I don't want to understate the practical importance, even of the difference between the closely connected cost approach adopted below and the avoidable cost of an activity approach, that I've just mentioned, because that in itself would have considerable practical significance, so we need to read this bearing in mind all these layers of potential stopping points.

O'REGAN J:

But even the –

GLAZEBROOK J:

Perhaps you might just explain how they're avoidable, avoidable costs here, when there seem to have been double-up costs for doing exactly the same thing, in terms of establishment fees?

MR GODDARD QC:

I don't think there's an issue about double-up that's still live post –

GLAZEBROOK J:

Well, there seems to be a double-up of all of the costs between Sportzone and MTF.

MR GODDARD QC:

Oh, I see what Your Honour's asking.

GLAZEBROOK J:

And is do – for what seems to be doing exactly the same thing, setting up what seems to be a contract and administering that contract. They don't seem to have avoided any costs, if one can believe their fee structures, is what I'm putting to you.

MR GODDARD QC:

If one looks at the comparison with other lenders, it's clear that there are people who were more expensive, but I think when we talk about, and I will come to that later, it's also, of course, the case that where you've got different elements of the service provided by different people, you have to apply the test to each provider of credit to a consumer, and let's not get into the issue of just how that breaks down, where you've got a, a true three party arrangement now, but when I talk about, what I was endeavouring to focus on was, first of all, the right approach as a matter of principal, to be adopted to the legislation, and then I'm going to come to applying it to the facts of this case. But, just to give Your Honour an illustration of the practical relevance of the avoidable cost test, among the heads of cost that were disallowed for each and every fee were the costs of training the people who perform the activity.

The Courts below, the High Court in particular, during the (inaudible) allowed the cost of the front line staff who carry out the activity, but they didn't allow the cost of training those people to carry out the activity, even though it's hard to see how they could do it effectively or efficiently without some training, and if you ask what would happen on an avoidable cost approach, obviously if you no longer, yourself, process and consider applications, then you don't need the people who do that work, but you also don't need the people who train them to do that work, and you don't need the people who supervise them to do that work. In addition, all those people, and this is, again, common ground, have computers sitting on their desks in order to perform this work, and after initially arguing that you couldn't recover depreciation on that

equipment, the High Court held in the liability judgment or the quantum judgment depreciation was recoverable. The Commission is not arguing otherwise now, but it remains the case that the Courts below did not allow other costs of owning that equipment; for example, the cost of funding the purchase of it.

So, when I buy a computer, have a basic, I have to lay out – but I can, I can rent it, of course, Your Honour, in which case its capital cost and depreciation and all those things are just bundles into a monthly lease charge and there, I think, there's no controversy about the whole of that being recoverable, but if I buy it, what are the costs I incur? Obviously I incur depreciation, but also, if it costs $3000, I have to find that $3000 from somewhere. If I borrow it, for example, then I have to fund the borrowing of that capital and the amount outstanding on that will, effectively, reduce as I depreciate over time, but there is a cost of capital, which is a real cost actually incurred, funded either from debt or from equity provided by shareholders, but shareholders also don't provide equity for free, so there's a real cost associated with owning that equipment and if a creditor gets out of the activity of processing its considering applications, it will not incur that cost, so that is another avoided cost which was not allowed below. So –

O'REGAN J:
But this isn't the approach that has been taken in setting the fees, is it, avoidable cost? So, your fee would still be unreasonable if the Court said avoidable cost was the appropriate measure.

MR GODDARD QC:
Yes, but by a lesser amount, which is relevant, because there's an outstanding paying for compensation, so the extend to – there are two reasons why the Court needs, in my submission, to answer the question of what is the right test. One is, or obviously the primary argument on appeal is that the fees haven't been shown to be unreasonable, but critically, even if they are unreasonable, by how much they are unreasonable is a very important issue in this case, and the implications, more widely, for MTF in relation to other customers, not just the 39, and the many other people who are parties to credit contracts, for example, that were entered into on the basis of the approach canvassed by the Commission in its draft guidelines will be affected by what the – the guidance the Court provides. So, it is very important.

O'REGAN J:

But it's not what, it's not your primary submission, though, it's a fallback from your primary submissions.

ELIAS CJ:

It's a necessary fallback, you say, if we, if we –

MR GODDARD QC:

It's quite an important fallback.

ELIAS CJ:

Yes.

MR GODDARD QC:

It seems to me that it's, the argument –

GLAZEBROOK J:

Who gave the evidence on avoidable cost in the High Court?

MR GODDARD QC:

The –

GLAZEBROOK J:

So, is this something we've got that we can say, "That's Mr Bowman or Mr Craig whatever his name is, sorry, I'm –

ARNOLD J:

Cregten.

GLAZEBROOK J:

Creg who?

ARNOLD J:

Cregten.

GLAZEBROOK J:

Yes.

MR GODDARD QC:

Cregten, yes, it's one of those names that –

GLAZEBROOK J:

Or whoever.

MR GODDARD QC:

The way that it – that language wasn't the way that it was formulated at first instance. What you've got is very detailed schedules of different types of costs and you have Mr Cregten going through in great detail. First of all, you've got Mr Todd putting in evidence of all those costs broken down in great detail, including in relation to each step of establishment, the cost of salaries, the cost of training, and so on and so forth. Then you've got –

GLAZEBROOK J:

Really my point was we say it's avoidable cost in some ways. Now, it was effectively agreed in the quantum hearing that MTF was not going to be able to re-do everything and bring up – it would have to be dealt with on the evidence that was already before the Court. Now, if you're saying we say it's avoidable cost but you're not pointing to anybody who actually did that exercise in the High Court or said how it would operate on a consensual or even a detailed basis. What on earth is the High Court supposed to do with it if we send it back? Because effectively you'd be sidestepping around what had already been decided in the quantum hearing that MTF was not going to be able to come along with a whole new aspect of their evidence.

MR GODDARD QC:

I'm not suggesting new evidence would be called. What I'm suggesting –

GLAZEBROOK J:

Well, how on earth is the High Court to deal with it if you can't point to who gave that approach in the High Court? I'm sorry, I didn't think you were answering the question as to who had given the approach in the High Court when maybe you were.

MR GODDARD QC:

No one said if an avoidable cost approach is adopted these are the specific categories of cost that are in or out but the evidence about the different costs that were incurred, who was doing what, is sufficient to found an analysis of the kind

undertaken by the Judge but applying a different threshold from the closely-connected threshold.

GLAZEBROOK J:

But how can we say that? I just don't understand how the Judge – how would we formulate it so that the Judge could do it on the basis of no evidence whatsoever using that terminology?

MR GODDARD QC:

In the same way it was done in the quantification hearing, bearing in mind that the parties went into the first hearing disagreeing sharply about the approach to be adopted and as a result what they did was produce a lot of very detailed information about every conceivable cost.

GLAZEBROOK J:

Yes, but that was the difference between variable cost, the extent to which you brought in a percentage of fixed costs i.e. 100 percent of the referable fixed costs on the MTF as against the more closely referable costs on the next approach of the Commission if they went away from variable costs but this is a totally different perspective.

MR GODDARD QC:

What MTF went in saying that if activity-based costing is the right way to do it and if you do an activity-based costing here are the costs associated with each activity. Here are the ones that are variable. Here are the ones that are fixed but are attributable and here's how. That information enables a range of different tests to be applied and to just take a very simple example, there was information before the Court about training costs associated with each of these activities and if one looks at Mr Cregten's schedules what one sees against the detailed figures for training costs is zeroes and the Judge accepted that at first instance. He said that training costs were out but if the Court says that approach is wrong and avoidable costs is the right approach then that is an example of a cost which is on that test clearly appropriately taken into account and so that one can go in. Now, there are others but I had hoped not to trouble this Court with going through those schedules pointing to all the individual line items which based on the evidence in the 23-odd volumes before the Court can be shown to be avoidable costs in particular activities.

GLAZEBROOK J:

Does that say anything more than the approach that you – that MTF had that everything that's referable in any manner to that is applied. Is it a different test? I don't …

MR GODDARD QC:

Yes, it is.

GLAZEBROOK J:

Well, to what extent is it a different test, then?

MR GODDARD QC:

It's a different test because an avoidable cost test does not capture fixed and common costs. So the critical difference would be that management costs that you would still incur –

GLAZEBROOK J:

Well, it probably does because if you – I mean, it may not mean that you can have three-quarters of a managing director if you get rid of three quarters of your business but it may well mean that you can pay when you take on a new managing director, you actually get someone that you do pay three quarters of because they're not having to supervise or deal with that number of staff because you've taken them out so, in fact, I can't see that it makes any difference whatsoever.

MR GODDARD QC:

Obviously the burden would be on a creditor to show that that sort of proportion of management costs would fall away as a result of not undertaking a particular activity and Your Honour is right that in another case that might be the position but there is no evidence to that effect here. So answering Your Honour's question, on the facts of this case one of the costs that would not be recoverable on an avoidable cost approach is the managing director costs and the board costs because there is no evidence to suggest that those would be different if, for example, processing and considering applications for credit was contracted out. And that will be true in many cases, but not all cases, and the practical approach which my learned friend describes in his submissions and the Court of Appeal touches on which I think is realistic that where there's a challenge to costs is unreasonable it's going to be in terms of access to information are necessary for the creditor to provide evidence of

the costs they incur and their relationship to whatever test is articulated means that mostly, I suspect, you won't go there but if a particular creditor wants to take on the burden of showing that they could avoid some management costs as a result of not engaging in a particular activity there's no reason not to permit that. That genuinely is a cost incurred in order to undertake that activity.

The difference – I mean, that is the critical difference between an avoidable cost approach and what one might think of as a more familiar, regularity building blocks approach involving an allocation of head office costs by some sensible mechanism.

GLAZEBROOK J:
Is there anything you can point us to in accounting principles that deals with – because it's odd that none of the witnesses that were put forward put forward this approach as being referable because most of the people were looking, as I read them, at particular accounting standards or economic standards.

MR GODDARD QC:
The accountants actually weren't looking at particular accounting standards.

GLAZEBROOK J:
Well, not particular accounting standards but in terms of the approach that they were taking in terms of what they thought should …

MR GODDARD QC:
What they were talking about was different management accounting approaches rather than accounting standards. They all accept that.

GLAZEBROOK J:
Well, okay, accounting approaches, not the technical accounting standards which I wasn't suggesting.

MR GODDARD QC:
And the other thing that is striking when one goes back and reads the accounting evidence is that none of the expert accounting witnesses suggested that there were accounting principles which informed concepts about costs in connection with or costs in relation to a particular issue. They said there was a range of ways you can do this depending on what you want to understand. Then if you look at the approach

of Professor Bowman, for example, what he says is, "The way I read the Act is that it's focused on variable costs of particular transactions and if that's right then this is how you do it." So the accountants' evidence was much more about –

GLAZEBROOK J:
Did any of them have an avoidable costs approach?

MR GODDARD QC:
No, none of them discussed that.

GLAZEBROOK J:
So that wasn't one of the range of ways they said you could do it in accordance with what you wanted to find out?

MR GODDARD QC:
They didn't use that terminology.

GLAZEBROOK J:
Well, did they, in not using the terminology, nevertheless take that approach, any of them?

MR GODDARD QC:
Certainly not Professor Bowman, although the cross-examination of him explored some of those issues. This question of what costs would you avoid if you outsourced and why are those not described as costs connected with an activity was consistently explored in cross-examination by counsel for MTF with the Commission's witnesses and it was one of the issues that was addressed in submissions in both Courts below. I've used the language of avoidable costs because it seemed to me that actually it was a good way of describing an intermediate approach that was within the range of approaches canvassed below, but the technical term was not used and I was simply trying to use a term that captures quite neatly the concept of what costs you incur in order to undertake an activity and that was certainly squarely the issue in the High Court and exhaustively canvassed by the witnesses.

Almost the whole of the cross-examination of Professor Bowman and a chunk of the cross-examination of Mr Cregten, for example, were concerned with exactly that issue. Why are you excluding some costs that are necessarily incurred in order to

perform this activity and the answer wasn't an answer given by reference to accounting principles. It was an answer given in reference to how they read the Act, which was as focused on the variable costs of transactions with individual debtors, particular debtors. Mr Kensington, the expert called by the appellants, was explicit about that, that accounting techniques provided no guidance as to which approach should be preferred but they enabled you to take whatever approach as a matter of law was appropriate and apply it to the various costs.

ELIAS CJ:
So it all drives off the statutory and we'd better move on to that. We've dealt with quite a bit around 5 or so, haven't we?

MR GODDARD QC:
Yes, we've anticipated some stuff. I do want to come back to the statute. I want to look not only at the definition of establishment fees but if we can go back to page 11 of the Act, so credit fees, fees or charges payable by the debtor under a credit contract to or for the benefit of the creditor in connection with a credit contract including insurance premiums but not including the following: interest charges, charges for optional service, default fees, and government charges, duties, taxes or levies. So that is a very general reference to all fees or charges other than interest, basically, and a couple of other things. It's not defined, importantly, by reference to costs and it's not defined by reference to any one activity.

The range of activities or services in respect of which a credit fee might be charged is not specified here or, as we'll see later, and then the last definition that I want to deal with is at the foot of page 12, default fees. Fees or charges payable on a breach of a credit contract or on the enforcement of a credit contract by a debtor but does not include default interest charges and again I just want to emphasise there that it's not defined by reference to costs, it's defined by reference to the trigger for payment so it's a fee or charge payable on certain events. There is absolutely nothing built into the definition which tells you anything about what might be in the default fee or charge. The only thing we're told it's not is that it's not default interest.

ELIAS CJ:
The other definition, of course, given the terms of the definition of credit fees which you should probably look at, is interest charged and it is striking that both interest charge and default fees, as you say, refer to – well, they're different in quality from

the definition of credit fees because credit fees is in connection with – it's more concrete.

MR GODDARD QC:

The establishment fees is more concrete, I think.

ELIAS CJ:

I'm so sorry, yes.

MR GODDARD QC:

Your Honour is exactly right. Establishment fees is a very concrete definition. All the others, credit fee, any fee or charge that's not interest or one of the other defining things, default fee, a fee charged on the occurrence of a breach and then there's actually a bit more precision around interest charges if we jump over to that on page 14, a charge that accrues over time and it determined by applying a rate to an amount owing so it's defined by reference to the way in which it's levied, not by reference to what it recovers for, and when we come back, the last definition, to page 13 and we look at the top of the page, default interest charges means additional interest charges payable on a breach of a credit contract by a debtor so that's where the additional charge payable, so that maps very much to default fees. You've got two types of fee or charge that can be payable on a breach of a credit contract, an interest charge, which is a default interest charge, and that's because the way it's calculated is by applying a rate to an amount owing at that time, and any other fee or charge payable on a breach which is a default fee or charge. So the Act expressly contemplates both as potential consequences of a breach and we'll then see how that substantively –

ELIAS CJ:

It is possible, though, to read these definitions as quite adverse to your argument, isn't it, because it suggests that interest charges, if you are charging charges that accrue over time and are determined as in the definition, they are excluded from your credit fees and credit fees are charges – oh, I see, yes, they're not charges for options.

MR GODDARD QC:

No, they're not, Your Honour, and I think these definitions are supportive of the argument to the extent the definitions take you anywhere independent of the

substantive provisions in which they're deployed, which I think we need to come to because what –

ELIAS CJ:

Well, they're very important to the structure, though, of the legislation.

MR GODDARD QC:

They are very important to the structure of the legislation and what we then see is quite careful regulation about the way in which interest charges must be described and applied – I'll come to those after the break – and then –

ELIAS CJ:

Except they're pretty neutral, too, in terms of content.

MR GODDARD QC:

They represented a significant change from the previous regime because they required effective interest rates to be used rather than nominal interest rates and they required interest to be debited in arrears and at the end of the period. I'll come to that but practices that were common and permitted under the prior legislation such as debiting interest in advance were prohibited by this Act to enhance the transparency and meaningfulness of the interest figure and one of the concerns that that produced, as in Australia, was that you could do an end run around that by using fees to recover interest in disguise in advance and that was explicitly identified as one of the key factors in the regulation of fees. Not the only one but an important one.

ELIAS CJ:

All right. We'll take the adjournment now, thank you.

COURT ADJOURNS:11.34 AM

COURT RESUMES: 11.51 AM

MR GODDARD QC:

Your Honour, so continuing to look at the scheme of the Act and the place of the relevant provisions in it, I think we can move on from the definition provision to part 2 which begins on page 19 of the Act, which is concerned with consumer and credit

contracts. They're defined in section 11. I don't need to delve into the detail of that now. I get the impression the Court's very familiar with.

I should just mention, I'll come back to it later if I remember, that MTF, of course, deals both with consumers and with business customers acquiring motor vehicles and the terms on which the two classes are dealt with were the same, which points rather against any exploitation of power, vis-á-vis consumers, but I'll come back to that when I come to the factors that, in my submission, should have been taken into account.

GLAZEBROOK J:
Well, presumably most of these business owners are relatively small business owners as are the majority of businesses in New Zealand?

MR GODDARD QC:
Well, simply because the majority of businesses in New Zealand are small that seems inherently likely, but it doesn't mean that they're unsophisticated. It varies from business to business, Your Honour.

GLAZEBROOK J:
Of course, but there's not necessarily a stark difference between a consumer and a business person. There may be but there's not necessarily.

MR GODDARD QC:
And there's a spectrum.

O'REGAN J:
So in the type of funding that MTF does where there's the dealer makes the loan, takes the security, then assigns it by way of security to MTF, is that considered to be globally a consumer credit contract? The two arms of the transaction are a consumer credit contract.

MR GODDARD QC:
It was common ground below that the provision of credit by MTF to a dealer is not a consumer credit contract but because of the assignment it was very clear that MTF fell within the definition of creditor.

O'REGAN J:

Oh, I see, okay.

MR GODDARD QC:

In the Act, and my attempt in the Court of Appeal to raise an argument based on that contractual structure was dismissed, first, on the basis that it hadn't been pursued earlier and the Commission said they would have wanted to call other evidence and, second, it would be fair to say that the Court made some tentative, negative noises about it. But I don't think there's any real dispute about the fact that normally a lender, lending to a retailer, on a back to back basis and taking security over their business would not be entering into a consumer credit contract just because –

O'REGAN J:

But where the dealer's entered into it with the intention of immediately assigning it, does the statute somehow –

MR GODDARD QC:

Well, the definition of creditor is very broad and includes the assignees and that was the basis on which they came in.

O'REGAN J:

That's all I need to know.

MR GODDARD QC:

The issue's not live here but when we come to look at the different ways in which the regulatory regime would operate on the basis of the test adopted below, the fact that different structures could produce very different outcomes, I think, is an important factor. Again, one would expect the way in which the regulation applies to respond in some way to factors that were important to the consumer, that were visible to it, even, and yet the form of security taken, whether it's an assignment or some other form of security, one would not have thought immediately made a difference to what fees could be charged as opposed to – yes, I'll come back to that.

So – and the reason that the dealings between MTF and the dealer are not consumer credit contracts is the debtor must enter into the contract primarily for personal, domestic or household purposed and, obviously, that's not what Sportzone was doing when it borrowed from MTF.

O'REGAN J:

Yes.

MR GODDARD QC:

Moving on then to subpart 2, required disclosure. This is important because –

GLAZEBROOK J:

Whereabouts are you sorry?

MR GODDARD QC:

I'm on page 22.

GLAZEBROOK J:

22, thank you.

MR GODDARD QC:

Yes, subpart 2. One of the differences in emphasis between the parties is whether a lower ceiling, to pick up Your Honour, Justice O'Regan's concept, on fees, but still be reference of a concept that could produce very different numbers for different people in some way enhances the quality of disclosure, and the Commission says it would and in my submission that's not right as long as you have all these difference types of fee permitted and as long as you have variation in amount, the comparison is necessarily a complex one and disclosure is achieved by disclosing the amount of each fee or charge. And then an analysis is required which is just as difficult whether the fee is set by reference to one approach or another. I'll come back to that, resist the temptation to go sideways.

So initial disclosure, and this is the important form of disclosure for the purpose of this argument. "Every creditor under a consumer credit contract must ensure that disclosure of as much of the key information set out in Schedule 1 as is applicable to the contract is made to every debtor under the contract either before it is made or within five working days," and there's then an ability to withdraw, as (inaudible) the Commission for continuing disclosure and requesting guarantee exposure.

But if we go to Schedule 1 to look at what must be disclosed, that's on page 94 of the Act and what must be disclosed is that information so far as applicable. Obviously

information about the creditor, information about the amount advanced, about a credit limit, where that's relevant. And then above paragraph (g), annual interest rate, one of the things that must be described is the annual interest rate or rates because, of course, there can be more than one where, for example, you have some borrowing on a fixed rate and a top up on a variable rate or an initial holiday and then a subsequent rate and whether it's fixed and to what extent, if it's calculated by reference to a base rate, how that works, all of these things are permitted. And then the method of charging interest over at (k), total interest charges. The total amount of interest charges payable under the contract if ascertainable but only if it would on the assumptions prescribed by regulations be paid out with seven years and, of course, that's not going to work in relation to a revolving credit facility or a credit card, and it's not generally going to be applicable to a residential mortgage because they won't normally be paid out within seven years.

Interest free periods and then credit fees and charges, and this is how transparency is achieved in relation to such fees. Again, "A description of the credit fees and charges other than interest charges that are, or may become, payable under the contract," unless disclosed back under (c), which was, "The amount and a description of each advance, charge or payment account for in the unpaid balance." So if a charge is included in the amount initially advance, you have to pick it up under (c). But one way or another it's going to be caught and that has to do with the description has to include when each fee or charge is payable if ascertainable and the amount if ascertainable, but if not, the method of calculation.

So you need a description of the credit fee or charge and that is to pick up one of the themes from my exchange with Your Honour, Justice Arnold, earlier is what's going to tie back to the reasonableness of the regime. You describe the field charge, a fee or charge for X. There must then be a reasonable relationship between X and the fee or charge up to that.

The payments required under (o), the amount of the payments or the method of calculating the amount, if ascertainable their number, and if ascertainable the total amount, and these are all things that will generally be possible in relation to a reasonably short term, finance contract to buy a motorbike, for example, X dollars per week payable, again, it's not going to work obviously for a credit card or any other revolving credit facility because it will depend on the extent to which the facility is used. Over the page, full pre-payment. How the reasonable estimate of the credit is

lost is calculated and whether a statutory procedure prescribed in regulations is used. We'll see how that ties into section 43. Security interests, obviously important, and then the next heading is the other one that's directly relevant here. Default interest charges and default fees. So these are described together. That makes perfect sense because they're just different sorts of charge that may be payable in the event of breach, the Court will recall from the definitions they're defined by reference to the triggering event, a breach of the contract. If it's a charge that's calculated by applying a rate to the amount outstanding it's default interest. If it's calculated in any other way it's a default fee. That's the difference between them. And what one has to provide in the disclosure is particulars that describe any default interest charges and default fees that may be payable under the contract and including how and when default interest charges and default fees would become payable.

Then there's the statement about the right to cancel, and then over on page 97 information about continuing disclosure and communications and other items prescribed by regulation. So whatever fees or charges are imposed by the contract must be disclosed in the initial disclosure and the information that's prescribed, when they'll be payable, what they relate to, all needs to be in that disclosure so far as applicable.

The way in which disclosure is provided is also regulated in the subpart but I don't think it's helpful to get into it. Subpart 3, which begins on page 29, deals with the debtor's right to cancel. This is the cooling-off period that runs from the time on which complying disclosure is provided, so if you don't do your disclosure properly the cooling-off period extends correspondingly.

Then subpart 4 –

GLAZEBROOK J:

Am I right that realistically you couldn't cancel these anyway because you've taken possession of the goods?

MR GODDARD QC:

You have to return the goods but then you can.

GLAZEBROOK J:

But you cannot do this if you've taken possession of any goods, page 96. I don't know what that means.

MR GODDARD QC:

Yes, I'm not sure how that relates to, for example, if we go back to the substantive right to cancel in 27(1)(b), in any other case returning to the creditor any advance and any other property received.

GLAZEBROOK J:

No. It just seems a bit odd, doesn't it?

MR GODDARD QC:

I don't know, I'm afraid. There's clearly a right to return property received.

GLAZEBROOK J:

Well, one would have thought so. It just seems – I just noticed that when I was looking at that and thinking what on earth does that mean?

MR GODDARD QC:

Yes, I hadn't noticed that before in the notice. It's not consistent with the substantive provisions as I understand them, but I'm sure it all fits together somehow.

GLAZEBROOK J:

Well, it should do, yes. Maybe it means if you've consumed them in some manner.

MR GODDARD QC:

Well, it doesn't work if it relates to services that have been provided, obviously.

GLAZEBROOK J:

And there could be goods you've consumed, as well, which then becomes difficult to return them.

MR GODDARD QC:

I'll have to look at that and see if I can make sense of it, but plainly there's a right to return property in certain circumstances.

And then we have subpart 4 on disclosure standards and how disclosure is made. I won't go through the detail of that. Subpart 5 I do need to look at a little bit because the relationship between interest charges and all other charges, fees, is an important part of the picture in this case. Subpart 5 begins on page 35 and the first important provision is section 37, creditor to ensure that contract specifies annual interest rate or rates and wherever interest is payable under a credit contract, as it normally is, the creditor must ensure that the contract specifies the interest rate or interest rates in terms of an annual interest rate or annual interest rates, so you're always going to have an annual interest rate by way of – but of course it may be one that is variable, in which case all you can do is under subsection (3) how it's determined and again if we think of bank variable rate ones it's basically a posted rate from time to time.

Early debit or payment of interest charges prohibited. (1), a creditor must not, at any time before the end of a date to which an interest charge applies require payment of or debit the interest charge, so this is the idea that you can't effectively compound by stealth, that you have to disclose a rate and then you have to apply it on a daily basis and debit the interest at the end of the day and the way in which you do that is then governed by the next few provisions, section 39, limit on interest charges, maximum amount that may be imposed, in the case of one annual interest rate applying to the unpaid balances, the amount determined by applying the daily interest rate to the unpaid daily balances. So you have to come up with a daily rate and apply it to the balance each day. If there's multiple rates (b) deals with that more complex situation.

Subsection (2) provides that you can simplify your annual interest rate to do weekly or monthly without having to do exact days. We don't need to get too bogged down in that, I don't think, and subsection (3) notes that none of this prevents the imposition of default interest charges. Those are provided for in section 40.

There's a prohibition on providing for an annual interest rate that differs according to whether the debtor has breached the contract generically but the exception to that is where the breach relates to a default in payment or to exceeding a credit limit so if a default interest charge is permitted, section 40(2), if the higher rates imposed only in the event of a default in payment and while it continues, or where a credit limit is exceeded.

So what we've got is a regime in relation to interest which says there's no substantive regulation of interest rates apart, of course, from the oppression regime in part.

ELIAS CJ:

So that's in part 5 as opposed to subpart 5?

MR GODDARD QC:

Yes, it's in part 5 because it applies to all credit contracts, not just consumer ones, whereas part 2 is just about the consumer ones. I will touch on it very briefly at the end but this Court has had cause to look at it recently. I think most of the Members of the Court either here or in the Court below in *GE Custodians v Bartle* [2010] NZSC 146; [2011] 2 NZLR 31 had cause to have a look at those oppression provisions reasonably recently, and we see that referred to expressly, Your Honour, in section 40(3). The provision saying you can have a default interest rate in these circumstances doesn't limit part 5. So the oppression rules still apply.

But subject to the oppression regime, there's no substantive regulation of the interest rate charged and there's explicit contemplation that default interest may be levied in the event of non-payment or where a credit limit is exceeded. And –

ELIAS CJ:

What's the rationale for default interest payments? I'm just wondering about the crossover with cost.

MR GODDARD QC:

Yes, there's important crossover. If one asks why one sees provision for default interest in credit contracts, then there are a range of purposes served by such a provision. One is –

ELIAS CJ:

But it's not to do with the cost to the creditor of the money.

MR GODDARD QC:

Because that –

ELIAS CJ:

So, it is a way in which the additional costs of defaulting debtors is covered.

MR GODDARD QC:

It’s one way in which you can recover the cost of bad debts.

ELIAS CJ:

Yes.

MR GODDARD QC:

That’s an option open. One of the critical things that one needs to bear in mind, and I'll come to this when I talk about default fees, is that by definition the people who default don’t pay the principal and they don’t pay default interest and they don’t pay any default fees, by and large –

ELIAS CJ:

Which is why you want to get all upfront from your general base.

MR GODDARD QC:

Well, you have to get it from somewhere else.

ELIAS CJ:

Yes, yes, I understand that.

MR GODDARD QC:

And the only question is, what methods of recovering the cost of bad debts are permitted, in circumstances where, by definition, you’re recovering it from someone other than the people who incurred the bad debt. You cannot recover the cost of bad debts from people who run up the bad debts. You’ve got to recover it from someone else, and one way to do that is through default interest charges.

You can say, well, all the people who are in default are higher risk. I will – so there is more risk associated with it, that’s one reason to charge a higher rate. Second, it is out of this group that there will be bad debts, you don’t have a bad debt unless at some stage you’ve defaulted, so it’s a group from which you can reasonably recover this, and third, and legitimately, you can have a disincentive to default or to exceed your credit limit, and default interest charges can serve that function and, in the context of European Union consumer protection legislation, it’s been explicitly held that it’s not an unfair term to provide for default interest rates, which are designed, in

part, to discourage default, because there's a legitimate interest in sending that incentive, including that incentive.

The question that I'll be exploring a little later when I come to default fees is why it is any less reasonable to recover some or all of the cost of bad debts through a fee than through an interest charge. And, in the absence of a good reason for that, then the reasonableness prohibition, the reasonableness prohibition isn't triggered.

GLAZEBROOK J:
Is the argument because you can charge what you like on interest, then reasonableness should be interpreted as saying you can charge what you like on fees; because that can't be right, can it?

MR GODDARD QC:
No, of course not.

GLAZEBROOK J:
So what, so perhaps I have misunderstood the argument, then.

MR GODDARD QC:
The argument is that there's nothing –

GLAZEBROOK J:
Sorry, subject to oppression charge what you like, I should say.

MR GODDARD QC:
Of course. There's nothing unreasonable in recovering the cost of bad debts from people who go into default. That's –

GLAZEBROOK J:
Sorry, we're, are we just talking about default?

MR GODDARD QC:
Yes.

GLAZEBROOK J:
Okay, sorry. I –

MR GODDARD QC:

Yes, and the que – and then the question becomes, is it un –

GLAZEBROOK J:

Because default fees are only charged to those who go into default.

MR GODDARD QC:

Exactly, Your Honour.

GLAZEBROOK J:

Yes, sorry, I didn't realise we were just talking about default.

MR GODDARD QC:

Yes, exactly, and so then the question becomes why is it unreasonable to do it through a fee rather than an interest charge, in circumstances where, by definition, either way, the people you recover it from are the people who ultimately do perform, not the ones who def – not the ones in respect of whom you run up the bad debts.

GLAZEBROOK J:

But then, the other argument is, well, if you can cover it through an interest rate, why do you have to then say, "Well, you," because it is exactly the argument I was saying, if you can recover it through an interest rate, why can't you recover it through a fee, so it was exactly that argument that you were making, wasn't it?

MR GODDARD QC:

It, through an interest rate, why can't you recover it through a fee, so it was exactly that argument that you were making, wasn't it?

MR GODDARD QC:

But if you – yes, if you can do it in one or other of two ways, then what the Act says, is it unreasonable to recover a cost through a fee rather than in some other way –

GLAZEBROOK J:

Well, no, the Act says you can't have an unreasonable fee.

MR GODDARD QC:

Yes.

GLAZEBROOK J:

And you can have an interest rate which is what you like, as long as it's not oppressive. That doesn't mean you can swap around between an interest rate and a fee and it still be reasonable, does it?

MR GODDARD QC:

It certainly doesn't mean that you can recover your cost of funds through fees. That's what the Act very clearly seeks to avoid, but apart from that, the question of how a cost of –

ELIAS CJ:

But you can recover your costs of overheads through fees?

MR GODDARD QC:

To the extent that the overhead contributes to the provision of a service to which the fee relates.

ELIAS CJ:

Of the service. Well, so does your borrowing to funds it.

MR GODDARD QC:

But the Act deliberately –

ELIAS CJ:

Your cost of funds. Yes, I know.

MR GODDARD QC:

Draws that line.

ELIAS CJ:

Yes, yes.

MR GODDARD QC:

But that, yes.

ELIAS CJ:

Yes. the, I'm sorry to be, sort of, stuck in a groove, but this definition of credit fees, the example given of insurance premiums, why isn't that something that should be very significant in terms of the scheme of the Act as an example of what was contemplated would be within the scope of credit fees?

MR GODDARD QC:

Well it is in if the creditor requires the debtor to obtain insurance cover from a particular insurer.

ELIAS CJ:

Yes, yes.

MR GODDARD QC:

So, if you say you have to take out insurance of this loan from this insurer –

ELIAS CJ:

Yes.

MR GODDARD QC:

It's a credit fee and it's regulated.

ELIAS CJ:

Yes, but what I'm pointing to is that is something which is a particular requirement for the particular debtor. It's a mile away from recovery of overheads. I'm just looking at the structure of the Act, not the policies and what the legislature might have provided for, but it does seem to me that it may be, in fact, providing some rigidity in terms of credit fees, because of the lack of regulation about the interest you can charge, which is constrained only by oppression and the market and disclosure.

MR GODDARD QC:

I think once we've had a look at the provisions on fees I'll be better placed to answer that.

ELIAS CJ:

All right, okay.

MR GODDARD QC:

Because they also deal with the difference between optional services and non-optional services and how it all fits together, so I think –

ELIAS CJ:

There is an answer.

MR GODDARD QC:

There is an answer, but I think –

ELIAS CJ:

That is in application of the definition?

MR GODDARD QC:

Yes, in the way it's used.

ELIAS CJ:

All right, thank you.

MR GODDARD QC:

And I think that's the more logical place for me to attempt to answer that question.

ELIAS CJ:

That's fine.

MR GODDARD QC:

So, having looked at the default interest charge provision, that brings us to subpart 6, "Fees", which is the specific subpart with which we're concerned here, on page 37.

ELIAS CJ:

And when you come to that, explain why it's necessary in that definition to have a specific exemption for default fees there, specifically exempted from credit fees.

MR GODDARD QC:

Because the idea is to have different substantive rules in relation to credit fees and default fees.

ELIAS CJ:

I understand, yes, I understand that.

MR GODDARD QC:

So, you need a mutually exclusive definition that there's –

ELIAS CJ:

Yes.

MR GODDARD QC:

Otherwise you'd end up with sections 42 and 44.

ELIAS CJ:

Yes, so it may just be a drafting.

MR GODDARD QC:

I think it's just a drafting thing, to separate them out.

ELIAS CJ:

Yes, all right, thank you.

MR GODDARD QC:

And apply –

GLAZEBROOK J:

Yes, but they don't separate out establishment fee.

MR GODDARD QC:

It's a subset of credit fees.

ELIAS CJ:

Well, so, too, could have been default fees.

MR GODDARD QC:

And they are dealt with differently in the substantive provisions that I'm just about to come to.

GLAZEBROOK J:

Well, no, I understand, but it's not an answer, that they're dealt with differently and therefore they weren't included. There must be something more to it.

MR GODDARD QC:

But then -

GLAZEBROOK J:

Establishment fees are a subset, but default fees aren't, but both establishment fees and default fees are dealt with separately, but it may just be a drafting thing.

MR GODDARD QC:

I think it is just a drafting thing, because what we then see is that in the provision on other credit fees in section 44 you have to have in subsection (2), "This doesn't apply to establishment fees," so it's –

GLAZEBROOK J:

Well, but they link credit fees and default fees, having said default fees aren't part of it, and then had establishment fees out separately as well.

MR GODDARD QC:

And that –

GLAZEBROOK J:

That I think it's just on drafting, perhaps.

MR GODDARD QC:

It is, and in the current version of the legislation there's a 44 and a 44(a), with 44 dealing with credit fees other than establishment fees, and 44(a) I think, if I've got the order right, dealing with default fees.

GLAZEBROOK J:

Yes.

ELIAS CJ:

But you can see why that would be, because credit fees are defined as those payable under a credit contract, and credit contract is the provision of, is defined as

the provision of credit. An establishment fee really stands outside that because it's pre your contract for credit, so you can see why they're dealt with separately.

MR GODDARD QC:
Well, you can see why you might have different substantive rules in relation to them.

ELIAS CJ:
I don't mean just a matter of policy. I mean in terms of the way the definitions in the Act hang together but you might come back to that.

MR GODDARD QC:
Let me come back to that. So subpart 6 fees and what we have cross-heading unreasonable fees is, in my submission, what all of this is about and we see that in subsection (1) of section 41. A consumer credit contract must not provide for a credit fee or a default fee that's unreasonable and so that includes within credit fee establishment fees, obviously, because they're a subset of credit fee. That's where the substantive fee comes. That's part of my answer to Your Honour.

ELIAS CJ:
Yes, I suppose it is.

MR GODDARD QC:
And if they are part of the credit fees, and if they weren't, they wouldn't be regulated by 41 at all which is plainly not the case. And then there are the procedural rules for re-opening or revisiting credit fees and default fees within a year of the fee being imposed or debited and it's subsections (2) through (4) that have been deleted, with effect, from June this year to remove the separate remedial regime, but I don't suggest anything in particular turns on that in relation to the issues before this Court.

So we have this test, a test of unreasonableness, and obviously if that stood alone we'd bring to bear all the familiar tools that we have for considering reasonableness from a range of other contexts including looking at normal practice but subject always to the overriding requirement that if everyone is doing something that's unreasonable then the Court won't just run with an industry practice. It will substantively review it.

ELIAS CJ:

Is credit fee or default fee that is unreasonable – does that unreasonableness relate not just to the amount charged in the fee but also the nature of the fee?

MR GODDARD QC:

That's an issue that is raised in the Commission's submissions when looking at the way this works. It's not one that's raised directly by this. So the question is, can you say, well, a fee of this type is simply unreasonable and the example the Commission gives in its submissions is an entertainment fee. Can you have a fee that's very clearly labelled "entertainment of dealer's fee" and provided then that you recover the cost of entertaining dealers charge that? It seems to me that the language of subsection (1) is broad enough to enable not only the quantum of the fee but also its existence to be called into question, but exactly where that limit lies I don't think …

ELIAS CJ:

But reasonableness in that context would have to be unreasonableness in terms of the scheme of the Act, one would have thought.

MR GODDARD QC:

And I think that's true in relation to quantum as well. It's reasonable having regard to the scheme of the legislation and the policy goals that it serves, which are to serve the long-term interests of consumers by making sure that appropriate products are available to them and that they can understand them as well as possible having regard to their inherent –

ELIAS CJ:

It's not just long-term, is it? I mean, it includes long-term, which is a point that you validly make but it's not just long-term interests.

MR GODDARD QC:

Well, it's all interests of consumers, but …

ELIAS CJ:

Including the immediate interests of the particular consumer.

MR GODDARD QC:

Of course, of course.

ARNOLD J:

On the establishment fee, you know, going to the point whether it covers both quantum and you do get in (a) the reference to the creditors' reasonable costs which conveys the idea that the particular costs, let's say if they were very inefficiently earned might not be reasonable, in other words, it's not simply an amount. It is looking at the quality of the underlying cost driver.

MR GODDARD QC:

No doubt about that at all and similarly it was common ground in the Court of Appeal that section 45, which provides for third party costs to be passed on, prohibits the charging of a margin is also subject to section 41. So the mere fact that some other person has charged a fee isn't a licence to pass it on if it's unreasonable, and that's important because you get related party arrangements that involve artificial inflated fees, particularly in relation to fringe lending practices where you might say, "Well, yes, this fee may have been charged by a third party but it's all flowing back to the benefit of the same people in the end and we're not going to say that it's reasonable to pass this on."

ARNOLD J:

Does that depend on there being a connection between them or if it was a truly independent third party but it was hopelessly inefficient and its fees were very high?

MR GODDARD QC:

I think that it's most unlikely that the efficiency of a cost structure was intended to be reviewed by the Courts under this regime, at least with any precision, for all the reasons that Your Honour gave in the Air New Zealand and Wellington International Airport case that the Courts are just not well placed to carry out that sort of inquiry into pricing.

GLAZEBROOK J:

Although if the market generally – on your assumption if the market generally had a fee structure of $10 and somebody chose to use somebody with a fee structure of $500 and so then they could get away with it in the marketplace why wouldn't you just say that was unreasonable, even if somebody can come along and say, "Ah, yes, but I actually have gold plated taps and that is my actual cost."

MR GODDARD QC:

Yes, if they retained senior counsel to conduct a detailed inquiry into the creditworthiness of the borrower and they sent some unreasonable bill for doing so, I think you might be able to say that that was simply an unreasonable approach, to use a very expensive but poorly qualified person to conduct the inquiry at great expense. The whole point of the reasonableness standard is that it enables any factor which goes to the reasonableness of the charge to be taken into account, including the degree of connection between the parties, including the relationship between – including the absolute amount of the charge and I can’t emphasise enough that it seems to me that there just is a difference between $3 and $300 and importantly the relationship between the charge and the amount borrowed, a $3 charge in the context of a $20,000 loan or a $300 in the context of a million dollar loan is just a different kettle of fish from a $300 charge in the context of a $1000 payday loan.

GLAZEBROOK J:

Well, a conveyance is used to argue that as well but it depends on whether the services are commensurate in terms of that, doesn’t it?

MR GODDARD QC:

It all goes into the mix, in my submission, and my concern about the approach adopted below is that the mix has ended up being very thin gruel. I am positively urging the Court to look at all these factors in assessment of what’s reasonable.

Coming, then, to – so what we have is this test of unreasonableness and then what’s described in – the test in 41(1), is the fee unreasonable?

ELIAS CJ:

By the way, it must also apply to the type, whether the type of fee is charged because of what the Court can do. You can annul as well as reduce. If it was simply an amount it would probably just be reduced, wouldn't it?

MR GODDARD QC:

That makes perfect sense, Your Honour.

So if you’re saying this is a fee of a kind that no one else charges and for which there is no reasonable justification it’s just a rort. You’d annul it. And as Your Honour says, it wouldn't matter if in fact some sort of cost of an eccentric kind was being

incurred by the creditor in that respect. So, then we come to three provisions, sections 42 through 44 and, to some extent, 45, which provide tailored guidance of varying kinds in relation to how you go about applying that basic unreasonableness test, and there's a tendency to slide into reasonableness and, in many ways, they are, of course, the other side of the coin, but it's, I think there's a signal in there which is, again, helpful when looking at what was sought here, that the prohibition is on unreasonable fees, so you've got to be brought to the point of saying this fee is unreasonable, it's outside the range of reasonable fees, before 41(1) is triggered.

What is the guidance provided? Well, looking quickly, again, at the structure of these provisions, 42 through 45, we see three different approaches to the guidance. In 42 there's a requirement that when you're considering an establishment fee and asking if it's unreasonable, you must have regard to certain specified matters. In s 43 we've got a definition of what it means for a pre-payment to be unreasonable. It's unreasonable if, and only if, it exceeds a reasonable estimate of loss. In 44, again, you've got a requirement, when looking at whether a credit fee or a default fee is unreasonable, to have regard to, and here we have a slightly different framework about what you have regard to; there's a cost/loss-related limb, and then there's the much broader paragraph (b) "Reasonable standards of commercial practice", which much go into the mix. And then, in 45 you've got, in relation to fees or charges passed on, a requirement that they, what's passed on not exceed the actual amount payable if it's ascertainable. If it's not, then when it's ascertained you have to adjust.

So, we've got a definition of what's unreasonable in 43. We very deliberately have something which is short of –

ELIAS CJ:

So, what's the policy of that if, I mean, presumably there must, there will be some administration charge if an agency, for example, requires the creditor to pay an amount, so policy of section 45 is against a fee being charged for that.

MR GODDARD QC:

No, I think what it says is that, again, it's all to do with being clear about what you're doing. So, if you are saying to the consumer, "This is a fee I've been charged by so-and-so and I'm passing it on," then you can't add a surreptitious margin.

ELIAS CJ:
No, so, but you can charge a credit fee.

MR GODDARD QC:
Yes, and arrange it.

ELIAS CJ:
Yes.

MR GODDARD QC:
So you can charge an insurance arranging fee.

ELIAS CJ:
Yes, yes.

MR GODDARD QC:
But, if you say, "This is the insurance premium that's payable to NZI," it must just be the insurance premium payable to NZI.

ELIAS CJ:
Yes.

MR GODDARD QC:
And that, again, comes back to my submission that one of the important functions served by these rules is to ensure that the consumer knows what they're being charged for and that there is some reasonable relationship between what the consumer is told they're being charged for and the matter in question, and different levels of guidance, different levels of structure are wrapped around those different things.

Looking then at, and I think section 43 is helpful because we do see there a definition of when a prepayment fee is unreasonable. That's in both subsection (1) in relation to part prepayments and subsection (2) in relation to full prepayments. For part prepayments, it's unreasonable if and only if it exceeds a reasonable estimate of loss and in subsection (2), full prepayment, it separates out and this is an illustration of what Your Honour is talking about, administration charges you can charge for separately but, and a different test applies to that but in relation –

ELIAS CJ:
It's a calculation in 54.

MR GODDARD QC:
What section 54, yes it is helpful to jump to that because again it shows us that where parliament wanted to be prescriptive it could. So that's on page 43 and what this says is it actually goes into the detail about how you must calculate a reasonable estimate. Just before I launch into the detail of that, it's worth pausing to note that in the context of high volume retail lending all of these fees will be set based on estimates and that's common ground. You're looking forward and setting a fee for the next X months or years or whatever of operation. So you're necessarily looking forward to predict what you expect your structure to be, what you expect your costs to be and importantly you're trying to make some sort of prediction about the number of contracts you expect to enter into, so that you know what the devisor is. This is very much regulation of the reasonableness of the creditor's decision making process.

The Commission's submissions try to say it's about the fee, not about what the creditor does but actually that can't be right because by definition you've got a budgeting process and an estimation of number of contracts process, in order to do some sort of division and we are absolutely focused here on the reasonableness of looking forward and doing this and it must be possible to know at the time you set the fee and start charging it whether or not you're committing a criminal offence, whether or not you're incurring civil liability. It can't depend on how things turn out at the end of the year with the benefit of hindsight and no one is suggesting that it does but all of these are estimation processes which means we are all in the familiar, we're in the familiar space of asking has the creditor or could the creditor have reasonably set a fee at this level.

ELIAS CJ:
Where are those regulations or just tell us what the regulations provide in English?

MR GODDARD QC:
They're not in English.

ELIAS CJ:
No.

MR GODDARD QC:
The regulations provide a formula, a reasonably gruesome formula for calculating loss on a prepayment which assumes a relending of the money. So it says how much have you lost?

ELIAS CJ:
Because you haven't.

MR GODDARD QC:
Because after taking into account your ability to relend at your current rates.

ELIAS CJ:
Yes.

MR GODDARD QC:
What the *Commerce Commission v Avanti Finance Ltd* (2009) 9 NZBLC 102, 662 (HC) case was about which is one of the High Court decisions, a decision of Justice Asher which is referred to in the parties' submissions was all about, was alternative procedures and in particular whether you could have a process for calculating your loss on a prepayment, calculated by reference to the difference between your cost of runs and your lending amount and His Honour said, I think it's common ground now that it's correct, that where you're not constrained in the amount of money you have available, so you could have made the new loans, whether or not there had been a prepayment, that's a reasonable approach. So the regulations have a very detailed formula which has certain inputs and if you follow that –

ELIAS CJ:
Do they include administrative costs?

MR GODDARD QC:
Yes they say there can be an allowance for administrative costs in relation to a full prepayment.

ELIAS CJ:
In relation to what aspect of administrative costs?

MR GODDARD QC:
I don't think –

ELIAS CJ:
I mean is it just the administration of the prepayment? What is it? Is it overheads?

MR GODDARD QC:
It doesn't say.

ELIAS CJ:
No.

MR GODDARD QC:
It just says "administrative costs" and it leaves that to be worked out. Perhaps just looking, rewinding to 51, which is amount required for full prepayment. What Your Honour says is, "The amount required for full prepayment of the consumer credit contracts was no more than the sum of the following." Let's leave insurance rebates. Unpaid balance, that's pretty obvious. "If expressly authorised by the contract the administrative costs incurred by the creditor arising from full prepayment or a charge equal to the creditor's average administrative costs arising from full prepayments of consumer credit contracts of the appropriate pass."

ELIAS CJ:
Yes but that's all about arising from full prepayments, so it's necessarily limited by that.

GLAZEBROOK J:
I'm not sure what you're taking from this.

ELIAS CJ:
No, no it's my fault.

MR GODDARD QC:
I'd like to agree.

GLAZEBROOK J:

No there's some point you're taking from it, but what is it? That that's prescribed but that's because a prepayment, I mean it's like default fees are relatively prescribed as well because they're for a particular thing. You can't prescribe credit fees when you can have a range of things that you can put under them. Isn't that your point?

MR GODDARD QC:

But default fees are dealt with in the same way as credit fees, which is to say you must have regard to certain matters. It's not an if and only if definition. My point is –

ELIAS CJ:

Well 51 is really sort of stopping a clog on the equity of redemption, really, isn't it? It's to limit that.

MR GODDARD QC:

And it's to ensure –

GLAZEBROOK J:

That particular policy on that?

MR GODDARD QC:

It's to ensure first transparency of what's going to be payable and second that the procedure for calculating it must be appropriate with a safe harbour in 54(2). If you use the regulation procedure but the ability to use some other procedure – all I'm taking from that is that if there was to be a rule that a fee is unreasonable, if and only if it exceeds a reasonable estimate of certain costs then it would have been a very simple matter to say so, so it would have been easy to draft either 42 and 42 in particular because it's establishment fees, which is tied to certain activities. But also 44, to say it's unreasonable if and only if it exceeds a reasonable estimate.

GLAZEBROOK J:

But you'd still have the argument about what a reasonable estimate of the costs were. You'd still be saying, "No, it's variable cost," and then they could have said variable cost but then you'd have an argument about what variable costs were. I wouldn't have thought in any event you'd have regard to that but in my example if you're charging $1 and your variable costs are 50 cents and everybody else's

variable costs are $100 in a practical sense it's very difficult to see anyone coming along and saying, "You're charging unreasonable fees at $1," and even more unreasonable to think that the Court would say, "Well, those are unreasonable," when they're $99 less than everyone else in the market.

MR GODDARD QC:
And yet the case of the Commission and the conclusion of the Courts below is that you can't look at that relativity and in my submission it can't be right.

GLAZEBROOK J:
Well, it's not saying you can't look at the relativity, is it? Well, it might be but …

MR GODDARD QC:
The Court of Appeal said, "You cannot look at that," and in my submission that's wrong. It's got to go into the mix.

GLAZEBROOK J:
Well, it may go into the mix. It may not.

O'REGAN J:
Well, we're talking about a criminal provision here so what you're saying is your conduct is governed by what your competitors do. How can that be right?

MR GODDARD QC:
Your conduct is governed by the reasonableness of what you do which is true of a number …

O'REGAN J:
So you're a person who wants to go to the Disputes Tribunal to say the fee is too high not only has to know all about MTF's costs it has to know about all its competitors' costs as well.

MR GODDARD QC:
It doesn't have to know about them to raise the concern but if it does and it's an outlier then that's going to be a good start, it seems to me.

O'REGAN J:

But an outlier – I mean, that means that the most inefficient person in the market defines what's reasonable, on your assessment.

MR GODDARD QC:

No, it doesn't, Your Honour, because of course you look at the mix and you also have to have regard – I'm not suggesting that you can avoid consideration of costs. It's a mandatory relevant consideration. You've always got to look at it so it goes into the mix as well, but if you can show that you are like Her Honour's example down the bottom of the market the fact that your costs are lower still, it seems to me, is a peculiar and taken in isolation unsatisfactory, implausible reason for saying the charge is unreasonable. So if you can say, "My fee for this service is substantially less than everyone else's." Now, because I'm using clever technology which has effectively zero variable cost, the electricity used when a transaction goes through a computer is basically zero so if you've got a really clever algorithm that runs on a computer with no variable cost in order to assess creditworthiness, and there are services like that available now, not so much I think in New Zealand but elsewhere and what is elsewhere tends to arrive eventually your variable cost is effectively zero. But if you would charge $10 for an establishment fee as against a variable cost of zero but everyone else is charging $100 or $200 then you're in a pretty good space, I would have thought, for arguing that your charge is not unreasonable and that question of principle is enormously important. Of course it's not the case that the standard is set solely by reference to what everyone else in the industry is doing. In so many areas that's been established.

In the credit contracts area in relation to the oppression remedy, although the Courts expressly authorise to have regard to what other people do, and reasonable standards of a cash rate is one of them, the Courts have also said on a number of times, the New Zealand Courts, "But of course if the practice of the industry is unreasonable that's not going to be good enough." In the context of negligence that's always been the case. To say all councils did this didn't get councils very far in the leaky building context because they were all failing to have regard to things.

O'REGAN J:

What we're talking about here is regulating the price charged to a consumer on a consumer credit contract. We're not talking about the entire building industry. So it's

got to be simpler than that and that's why the legislation directs you towards costs because that's an easy way to measure it.

MR GODDARD QC:

As a mandatory relevant factor but not as the only factor.

O'REGAN J:

Correct, yes, but it's a mandatory consideration.

MR GODDARD QC:

Yes. And again, there are a range of techniques that could have been adopted. Obviously fees could have been prohibited. That was considered and rejected. There could have been an if and only if test tied to a reasonable estimate of costs associated with the matter. Absolutely no reason why that couldn't be drafted, very easily drafted. That wasn't what was done. Then you get all the different expressions. There's no rocket science in this. The *Sanford Ltd v New Zealand Recreational Fishing Council* Inc [2008] NZCA 160 which I think, again, three members of this Court sat on in the Court of Appeal was looking at the difference between the obligation to have regard to something and an obligation to have particular regard to something. These are all well-trodden statutory formulae and the Courts have repeatedly said that where there's an obligation to have regard to something it must receive genuine consideration but it's not decisive and, indeed, it may be outweighed by other matters and the example of the $10 establishment fee for my completely computerised lender is a really good example of that. One might say the variable costs and even the technology costs are, you know, peanuts, less than $1. But this is so much less than everything else that the mandatory relevant consideration of costs is not decisive here.

O'REGAN J:

The whole case for MTF is a cost-based approach. MTF says they did it by costs. They're not saying they did it because their competitors were charging this. They're saying they took all their costs and divided them up and allocated them and that's reasonable. That's your case. So I just don't know why this helps you because this is not what you're contending for.

MR GODDARD QC:

It’s not but I think that’s an oversimplified version of MTF’s case, with respect, Your Honour. First MTF is not saying we took all our costs. We’re saying we took 70-something percent.

O’REGAN J:

They did say they were taking all their costs. That was the evidence. That might have been modified now but that was certainly where they started from.

MR GODDARD QC:

No, the evidence was always that it wasn’t all the costs, that some costs were out, others were in and that’s in Mr Todd’s first brief. It’s been consistently the position.

GLAZEBROOK J:

Well, no, unrelated costs were out. But all related costs were in.

O’REGAN J:

The submission you made was the only ones that were out were costs that didn't relate to the financing business.

MR GODDARD QC:

No, they’re for each fee. It was a submission on a fee by fee basis and I’m saying for each fee you can’t recover the cost of something which is wholly unrelated to the matter to which the fee relates, so you look first of all at what fees a creditor decides to charge and discloses that they are charging and in relation to that fee you cannot recover, in my submission, anything that’s unrelated to that does not contribute to the ability of the creditor to provide the service to which the fee relates, and there will always be activities, and therefore costs, that fall into that. But in the circumstances where MTF wasn’t saying it was charging another lending costs fee, it had fees that were defined much more narrowly than that, there are going to be costs that fall outside it.

Of course, that again – yes, so in relation to activity, in relation to creditors because again that point I made earlier, the MTF was also lending to non-consumers and was allocating a proportionate share of costs to that part of the business, so it wasn’t an unthinking lumping of all costs in. It was an approach which, in my submission, was within the range of reasonable approaches having regard to not just the types of

costs sought to be recovered but also the absolute amount, also relativities, and there was evidence about how that was considered by the project team that was looking at these issues, and various other factors. So it's certainly a more nuanced argument than that. Whether it's in whole or in part correct is the issue that we're exploring here, but it's not as simple as to say that your whole costs of your business can be recovered through fees, whatever you call them. That would be an ambitious argument and it's not one I'm running here.

O'REGAN J:
Well, it's a – the argument is that, except to the extent that we can't allocate them, all costs are in and that's a reasonable thing to recover.

MR GODDARD QC:
Except to the extent that we can't reasonably allocate them to the matters that we have told consumers we are charging them for.

O'REGAN J:
And that's – having done that exercise, that's what the figure came from isn't it? So it didn't have any – it wasn't – they didn't say, "Well, if we did this allocation the fee for the establishment fee would be 250 but because our competitors are only charging 160, we'll only charge 165 or something."

MR GODDARD QC:
I think – I'm just trying to remember the detailed evidence and I'll check it with my learned juniors over lunch time but I think, in relation to some fees, there was an adding up of costs which came to a higher number and a decision to charge a lower rounded number. So the, you know, the $190 establishment fee, for example, was not the product of a mathematical calculation that came out of the 190. It was the product of an assessment of costs that came up, I think, somewhere north of 200 and a view was taken to price it at 190.

GLAZEBROOK J:
Like the 199 instead of the $2 that –

MR GODDARD QC:
Yes.

GLAZEBROOK J:

But that's not actually –

O'REGAN J:

But I don't – well, I didn't sort of read that as being because of any consideration of what the competitors were doing. It was just – there was just a unilateral decision by MTF that it would look better –

MR GODDARD QC:

No I think it was relevant to competitors and we see, for example, actually in correspondence with Sportzone, itself, and I'll just provide the reference, I won't go to it. But when MTF was dealing with Sportzone about Sportzone using MTF as opposed to other people, there's an email in volume 8 at page 1394 where Mr Holtham is saying to MTF, "Look, these are the fees that are charged by other finance companies that I could go to," and basically saying, you know, "What are you doing?"

There's no doubt about that. There is, you know, competitive pressure on the range of fees and the quantum of those fees and that they go into the mix.

ARNOLD J:

I must say I got very confused not about – because I had read Mr Todd's evidence as being that he had identified, or they had, a whole range of cost centres and then he'd booked it. There are four fee categories, establishment, maintenance, settlement and arrears, and gone through and allocated those costs from the cost centres to those various activities, and there's this chart in his evidence showing how he's done that. And then he says, "We didn't include all of our costs in this," and the two examples he gives are the costs relating to funding arrangements and the cost of capital. Those are the only examples that he gives of costs not included, but you're saying there are, as I understand it, there's some other substantial quantity of costs not included.

MR GODDARD QC:

The largest amount of costs that wasn't included were the costs of the running the securitisation programme and procuring finance. So –

ARNOLD J:

Well, he's already said, though, that. The costs relating to the funding arrangements and then he discusses all that, yes.

MR GODDARD QC:
And that's the principal category, and the one that matters for present purposes.

ARNOLD J:
Yes, okay.

MR GODDARD QC:
Apart from that he's gone through an allocated but, then, there was a further step of looking at what dropped out of that and deciding in the light of that, looking forward, bearing in mind you're doing it on the basis of budgeted costs, budgeted numbers, what your fee should be, and that – it's not an accident that all of these numbers are found numbers.

ARNOLD J:
Yes, I understand.

MR GODDARD QC:
And that's a good example, in my submission, of the sort of reasonableness overlay that must be acceptable. If you do that sort of forward looking analysis and you figure out that, you know, on doing your budgets you're going to have a most likely cost, one that's hard to pin down, of $187.24, then I don't think it's unreasonable to say 190.

ARNOLD J:
But nobody's disputing that are they? I mean it seems to me you're creating all these sort of horror shows because if you take the establishment fee, inevitably you're going to be using, aren't you, the average reasonable costs for the appropriate class of consumer credit contract because you are going to be projecting forward. You are going to be estimating the number of loans that you did, the number of people you need and all the rest of it.

MR GODDARD QC:
For a high volume retail lender that's always going to be the case.

ARNOLD J:
That's right, that's what we're talking about.

MR GODDARD QC:
There may well be and, even then, there may be specific transactions where you say, "I'm actually going to recover the actual costs from you if," you know, if someone goes in wanting to buy the newest collector's Ferrari from the 1950s, for example, for millions and millions of dollars. There may well be specific costs associated with obtaining a valuation of that security and entering into a tailored contract.

ARNOLD J:
All right, well, let's accept those but, I mean, most of the time you are going to be, as you say, estimating looking for the future and, I mean, I don't think there's any suggestion, is there, that if those estimates turn out to be wrong in some way that somehow you've got a problem because the fee is reasonable when you set it because it's got to be projected out the next year?

MR GODDARD QC:
I think that's right, although I was a little bit puzzled by the submission from the Commission that it's not about the creditor's process. It's about the fee because I don't think you can get away from that forward looking process that Your Honour's just described and the reasonableness of that and what was taken into account in doing it.

O'REGAN J:
But it doesn't matter here, does it, because your process was based on a completely different cost base than the Commission's. I mean, the Commission's not saying, "You had the right basis but you calculated it incorrectly." They're saying, "You used the wrong measure of cost."

MR GODDARD QC:
But it's not a binary dispute in which I have a MTF's approach is right or the Commission's approach is right. There are a range of other –

O'REGAN J:
Yes, but in the end the Court has to make a decision. You can't just say it's a great big blancmange and it's incredibly hard to work out and we're all just lost in a fog.

You have to come to an answer and we've got to have a test that's capable of reaching an answer.

MR GODDARD QC:

And I'm suggesting a number of possible options. One is that it's neither more nor less of a blancmange than the test for imposition of a duty of care in tort, which is that you do look at all the factors going to reasonableness. The Court is well used to doing that. I think a number of us have some reservations about the extent to which that's a certain and reliable guide but nonetheless it's very familiar. And the standard of reasonableness is used in many other statutory and common law contexts as well. That's one possible test.

The other approach that I am suggesting is if there is more of a narrower focus and a focus on costs and, actually, even on that test when you come to ask the important question which costs have we been told we must think about on the way to the section 41 evaluation, that the line was drawn too narrowly below. And there are other costs, including costs which have been precisely quantified by MTF in its evidence which on a reasonable approach could have been included. And I think the simplest litmus test for that is the cost of training the staff.

There are two litmus tests. I think it's helpful to come back to. One is the cost of training the staff whose salaries have been held to be recoverable. And it seems, in my respectful submission, hard to justify a test that says whatever you pay these people to do their job can be taken into account as a relevant cost but the cost that you incur in order to ensure that they know what they are doing when they do their job, that they're not just, you know, someone straight off the street with no idea, and that they do it lawfully and appropriately, effectively and efficiently is not a cost of providing that same service.

ARNOLD J:

It seems to me part of the problem we've got is, I mean accept for the moment that, accepting the validity of that submission, the way the case seems to have progressed in the High Court, and it goes back to the earlier exchange you had with Justice Glazebrook about your avoidable cost approach, you have two extremes really, or relative extremes with the Commission arguing for a variable cost approach and your client asking for a sort of fully attributable –

MR GODDARD QC:

Yes, of the recoverable costs, yes.

ARNOLD J:

And the trouble is, it seems to me, at least at the moment, that there is an obvious flaw in your client's position and perhaps most dramatically represented by the claiming the costs as part of the establishment fee of developing optional products when the definition of establishment fees says you cannot charge for a service that's optional, and yet the claim is made that, okay, we can't charge for that but we can charge for the R and D department that develops those products.

MR GODDARD QC:

Yes, and some marketing costs are also a little bit hard to justify. There's no doubt about that.

ARNOLD J:

Right, so I can criticise that approach.

MR GODDARD QC:

Yes.

ARNOLD J:

It may well be that the Commission's approach was too hard line in the sense that you're talking about. But I don't see that we can do much about that.

MR GODDARD QC:

No, Your Honour can because first of all the reason that leave has been granted is because an issue of public or general importance is raised about how these provisions work. And there is a huge – I don't think there's been any other case I've done in this Court in relation to which I have had more enquiries from other lawyers about when it's going to be heard and, you know, what the issues are. There's huge interest out there. It's seen of enormous practical importance to understand whether the approach adopted below is going to be endorsed unqualified or whether it is in some respects wrong.

So first of all, to get the approach straight is a matter of public or general importance. Second, there is enough information in the detailed evidence before the High Court,

without calling anymore evidence, to be able to go back and apply a different test. And it was common ground between the parties in moving to the quantum judgment before appeals were heard that that would happen and that the argument about how to apply the test enunciated by the High Court Judge would happen without prejudice to the argument that that test was wrong, either wholly or to some extent.

So it would be – there are things the Court can do about it. The Court can say, "You should factor into your calculation costs that would be avoided by not undertaking the activity or question." And then you go back to the evidence and there's an argument about what additional costs have been demonstrated fall into that category but there are a couple that definitely do. The training costs which are, you know, line items, which were disallowed, and the Judge expressly discusses them and says, "No, they're not tied to particular transactions, so they're out," so very much a variable cost approach adopted by the High Court Judge in dealing with that. In my submission, plainly come back in. That alters the outcome and it should, if that's right, if that should have been permitted, the appeal should succeed to that extent.

Again, the full cost of ownership of technology. If just makes no sense to say you can recover depreciation on the computer sitting on someone's desk but not the rest of the cost of owning that computer.

GLAZEBROOK J:
Well, that may imply that the depreciation shouldn't have been there in the first place because it's just directly referable cost to the particular transaction which I must say is something that appeals to me.

ELIAS CJ:
It's time to take the adjournment and perhaps finish what you're going to say there but if you've finished your run through of subpart 5, I, at some stage want you to come back and convince me that these fees are proper in any event in the scheme of the Act. So much of what is being discussed between counsel and the Bench is really the sort of thing one would expect, if this were a regulated industry in terms of working out what costs can be covered. I think there is a fairly powerful argument that the scheme of the Act envisages additional services and fees for those, which is a much more confined inquiry and, frankly, would make the Act a lot more workable. So I would like you to look at that when we come back.

MR GODDARD QC:

I'm happy to do that. I expect to be able to satisfy Your Honour that that's not what it's about, both by reference to the text and also very much by the legislative history.

ELIAS CJ:

Well, all right but, you know, I'd like to see it in the text.

MR GODDARD QC:

Yes, and the establishment fee, the cost of advancing the credit, you're necessarily talking about something which is integral to it, if not an optional extra to get advance to the credit. That's part of an establishment fee.

ELIAS CJ:

No, but the scheme of the Act may be that that's what interest covers. Anyway – and everything else is an additional thing. The insurance charge, the pre-payment, all of these unexpected or additional or targeted services, yes, there's provision for fees but, anyway.

Thank you, we'll take the adjournment.

COURT ADJOURNS:1.06 PM

COURT RESUMES: 2.16 PM

MR GODDARD QC:

So I have I think a question from Your Honour, the Chief Justice, that I should deal with first because it relates to the legislation. I am conscious that there are a few, if not questions, at least loose ends left from questions asked by Your Honour, Justice Glazebrook, as well, but I'm going to be better placed to deal with those efficiently I think after I have looked at some of the legislative history. So I haven't forgotten them, I will come back to them.

GLAZEBROOK J:

I probably have.

MR GODDARD QC:

And then I want to loop back, after I've done that, to a question which or an assumption which seems to me to underpin some of the questions I've been asked which is that lower fees is a good thing, that it's in the interests of consumers to have fees that are lower rather than higher and that in my submission is not correct and is not consistent with the more economically sophisticated approach that was taken to the design of this legislation and that's also best addressed after I have looked at those design choices.

So let me deal first with Your Honour the Chief Justice's question which was really, as I understood it, whether fees could only reasonably be charged for something that was in some sense an extra service or an additional service over and above the core matters involved in the –

ELIAS CJ:

Well in the provision of credit.

MR GODDARD QC:

The provision of credit.

ELIAS CJ:

Which is the subject of the credit contract.

MR GODDARD QC:

Yeah, so I suppose the first points to note are that obviously establishment fees are expressly provided for.

ELIAS CJ:

Yes.

MR GODDARD QC:

And default fees are expressly provided for.

ELIAS CJ:

Yes, yes.

MR GODDARD QC:

So to the extent that there are other credit fees they must relate to something else and the question then becomes to what and if we go back to the definition of credit fee on pages 11 and 12 of the Act. The definition is perfectly general in terms of fees or charges payable under the credit contract or payable by the debtor to or for the benefit of the creditor in connection with a credit contract.

ELIAS CJ:

Sorry, at some stage can you point me to the reference in the materials where I find the provision of the contract which these fees are charged under. I haven't looked at the documents.

MR GODDARD QC:

Of the particular MTF, yeah.

ELIAS CJ:

Well one of the 30 something or other ones. Presumably it's referred to.

MR GODDARD QC:

Yes I'll do that.

ELIAS CJ:

Yes thank you. It was just seeing under a credit contract.

MR GODDARD QC:

It can be or to or for the – but it needn't be under the contract, it's anything, or payable by the debtor to or for the benefit of the creditor. So an application fee that you pay before there's any contract is also covered.

ELIAS CJ:

Yes.

MR GODDARD QC:

Even though obviously it won't be provided in the contract because it precedes it and it's deliberately a very general definition because the idea is that you want to catch and regulate under subpart 6 any form of fee or charge other than interest that the debtor pays to the creditor, under the contract or broadly in connection with it but

what it doesn't, and we see if we turn over the page to the exclusions it doesn't include interest charges, so it doesn't include anything that's calculated by applying a rate to an amount outstanding and then be a charge for an optional service. If something's truly optional then the fee for it is not a credit fee and is not subject to subpart 6, because you can choose whether or not to take it in conjunction with the credit contract and we see that same exclusion of optional services in the definition of establishment fees over on page 13.

It's also a helpful definition to look at for the purpose of answering Your Honour's question because it's clear in my submission that establishment fees, which are a subspecies of credit fee, include matters that are integral to the provision of the credit, including documenting the contract and particularly advancing the credit. So the fee for advancing the credit by definition, not interest, because it wouldn't be an establishment fee if it were an interest charge and a fee for something which is an integral part of the process, not some sort of add-on, it's fundamental.

Now, the only sort of fee we're talking about in this case other than an establishment fee or a default fee is the administration fee, the monthly administration fee that's charged, and that obviously comes within the definition of –

ELIAS CJ:
And the service that is provided for is the provision of credit?

MR GODDARD QC:
The matter that is provided for, it's the matter.

ELIAS CJ:
Well, it's a fee for a service, isn't it?

MR GODDARD QC:
No, that's not how it's described necessarily, Your Honour. We see that actually quite nicely in section 44. I was going to take Your Honour to this. If we look at 44(1)(a), determining whether a credit fee – let's focus on that – is unreasonable the Court must have regard to in relation to the matter giving rise to the fee, so it talks about matters, whether the fee reasonably compensates the creditor for the following: (1) any cost incurred by the creditor including the cost of providing a service if the fee relates to the provision of a service, so it's clearly not limited to the

provision of services. It may be what it's for but the matter may be something other than a service and the matter may be the –

ELIAS CJ:

Well, the default fee because this has to apply to both.

MR GODDARD QC:

Yes, although as I think the parties agree it's subparagraph (2) that most naturally reads as relevant to defaults but Your Honour is right, both are relevant because there may be costs incurred.

ELIAS CJ:

I'm just pointing to your emphasis on if the fee relates to the provision of a service.

MR GODDARD QC:

The language of matters giving rise to the fee is clearly intended to be more general than services.

ELIAS CJ:

The matter giving rise to the fee.

MR GODDARD QC:

Yes, so the matter may not be a service. As Your Honour points out, it may be –

ELIAS CJ:

Sorry, the matter giving rise to the fee here is the provision of credit, isn't it?

MR GODDARD QC:

It's the ongoing administration of the contract.

ELIAS CJ:

What's the fee charged to the debtor for?

MR GODDARD QC:

The administration fee is for sending out statements, it's for the administrative costs associated with having the facility in place but importantly it's not a cost that is related in any way to the amount advanced. You send out the same – it costs the same to

post out a statement to me whether I borrowed $100 or a million and I'll come to that. Your Honour will see that when I go to the legislative history but one of the themes that comes through is that there are some costs incurred in providing credit services that are proportional to the amount advanced or to the time for which the loan is outstanding.

And other costs which bear no relationship to amount and one of the concerns expressed is that it shouldn't be necessary to lump those costs into an interest charge because you end up with a cross subsidy, people who have borrowed more or for longer end up paying more, even though the cost of that matter in relation to that creditor is the same and that's why it does make sense for something like an administration fee or if Your Honour thinks of the credit card annual fees that are a familiar feature of consumer transactions, that's an annual fee which is designed to cover the cost of having the facility in place and sending out statements and doing all those administrative things and it doesn't matter whether you use the card not at all or whether you use it a bit or whether you use it a lot, there will be the same administrative costs. What I think is apparent from certainly the legislative history but also just from a consideration of the cost structure of providing this sort of service is that it's not unreasonable to recover through a flat fee rather than an interest rate costs that have no relationship to the amount borrowed.

So that's the concern about lumping into interest rates costs that are not variable with the amount borrowed or the duration of the borrowing is a concern that, as we'll see, was picked up in the pre-legislative material that had been the subject of a productivity commission, I think, report, or pricing surveillance authority, its predecessor in Australia sometime earlier. That's referred to in passing, as well.

So let me go to that because I think that.

ELIAS CJ:
Is there anything more you want to say about this? It's just that do you not want to say anything about the example given or the fact that all of these are four discrete matters which are not simply consequential on the provision of credit?

MR GODDARD QC:
Well, I think the documentation alone is simply consequential on the provision of credit.

ELIAS CJ:

Well, that will be in the establishment.

MR GODDARD QC:

That's a subset. What I think that illustrates is that it's not the policy of the legislation that matters that are inherent in the provision of credit should not be recovered through the charging of a fee. That's a really good example.

ELIAS CJ:

I'm not really convinced by it so far but maybe there's nothing more to be said.

MR GODDARD QC:

Is it only the administration fee as such that Your Honour is wondering about?

ELIAS CJ:

Well, I'm not terribly clear what fees – how they're being – it bothers me that it's left to the invention of the creditor to describe a fee and as long as once described there is some connection.

MR GODDARD QC:

And that was a deliberate choice, as we'll see, not to regulate the types of fee. There are some countries that do that. That was discussed and that was explicitly rejected as an option and we see nothing – in a way, my strongest point is that we don't see specification of the permitted types of fee in this legislation.

ELIAS CJ:

No, but all the illustrations given are discrete services or mandated fees like the prepayment fee which, in a narrow compass, it's because of the ambition of the fee setting here to cover all the – or a substantial part of the costs of the creditor that there are these complexities.

MR GODDARD QC:

In this case, the only fees charged by MTF are very orthodox types of fees. The establishment fee expressly contemplated by the Act, default fees expressly contemplated by the Act. The only other one we're talking about is a fee labelled an administration fee.

ELIAS CJ:
Yes.

MR GODDARD QC:
Now, it may well be the case that the Court finds that there are costs that are not recoverable by a reference to those matters because they're not within those descriptions and then we get into the interesting question of whether they might have been recovered through a fee otherwise described but that's not a necessarily part of my argument here. It's not an issue I was intending to embark on and if the Court were to find that having chosen certain categories of fee, that necessarily limits what costs are recoverable under those headings, then that's the position and indeed it follows from my argument that that could be the case. For example consider a lender that chooses not to charge a default fee. It has a default interest charge but no separate fee payable on default. It's necessarily the case that costs that flow from defaults cannot be included in any other fee charged. You can't charge it in an establishment fee, you can't charge it in an administration fee. So it may well be the case Your Honour that by choosing not to charge a particular type of fee with a particular description, a creditor disables themselves from recovering costs associated with some matter or some feature of the credit service.

Very much a part of my argument that you start by identifying the types of fee that the creditor says they are charging and disclosed and here we have three very orthodox types of fee. The Commissioner has never suggested that administration fees are not permissible under the legislation. They're very common and they're expressly contemplated in the policy analysis leading up to the legislation, so we don't need to get into, except in order to understand the scheme of the legislation, what other fees might be charged.

What we also see is a very conscious choice not to limit the types of fee that can be charged and that flows through into the absence of any provision saying you can charge fees for this but not for that. What there is, is section 41 which says, "You must not charge a fee which is unreasonable" and I have accepted the possibility that there would be some types of fee that in themselves are so unreasonable that you don't need to go beyond that.

ELIAS CJ:
Well it's not "so unreasonable" but "that are unreasonable."

MR GODDARD QC:
Yes but that issue is not engaged here and it is very much part of the statutory scheme that flexibility and how credit is priced as between interest and fees was part of what is sought to be achieved. Just in terms of, because a number of Your Honours were saying to me well where is this in the legislation. Reference to pricing flexibility is not in as many words in the legislation as I submitted, it's implicit in the interests of consumers because it's in the interests of consumers to be served by a range of products priced and arranged in appropriate ways but it was expressly recognised in the explanatory note as one of the objectives of the legislation and perhaps, at the risk of working backwards through the legislative history, it's worth going to that. So volume 3 of my materials has all the legislative history material I want to go to in it. And under tab 20 there's the explanatory note to the Consumer Credit Bill which became the CCCFA. And what I'm going to look at this and at the *Hansard* and then rewind to look at the more detailed policy materials which led up to it which both parties to this appeal have referred to.

So tab 20, explanatory note, this Bill replaces the Credit Contracts Act and the Hire Purchase Act 1971. Background, those Acts have become outmoded. Statutes conceived and drafted in the 1970s. Since that time marks technological and economic change, particularly computerisation and financial deregulation. A number of problems identified. Summary of major reforms over on page 2. It's worth looking at the third and fourth paragraphs here. First the third paragraph, "The Bill limits the manner in which interest may be charged, for example it may not be charged in advance. This provides rules that are fair, flexible and transparent for debtors and creditors." Next paragraph, "The Bill allows lenders to impose any fee provided it is not unreasonable. Unreasonable is in respect of establishment and prepayment fees as defined and a general standard is set for other fees, thus pricing flexibility is maintained." So we see a reference to that there, "while scope for creditors to avoid restrictions on interest charging is limited."

So that policy objective of preventing the charging of interest disguised as fees in a way which defeats the rules about interest charging described in the previous paragraph is a very important element of the regulation of fees and that desirability of pricing flexibility expressly noted there.

The specific provisions we're concerned with are discussed on pages 7 and 8 of the explanatory note. Again it's worth beginning by looking at –

GLAZEBROOK J:

It's going to depend a bit on your terminology in terms of interest isn't it? Because if you say you were allowed to have establishment fees that took everything into account, then depending on your definition of interest and whether you think that should be within interest, actually you are having people prepay interest. So you're having them prepay interest plus then because you're putting it into the capital, having them paying interest on the prepaying of the interest throughout. So unless you define interest and prepaying of interest is only cost of capital and that's what you say they were saying which isn't the case in the Act because interest charges are just the regular amount isn't it that you pay?

MR GODDARD QC:

Interest is defined in the Act by reference to an amount payable by applying a rate to the amount outstanding.

GLAZEBROOK J:

Well exactly so that isn't just cost of capital plus a margin that you're allowed to put in. It is just whatever is a rate. So if you're right and you are allowed to load every single cost apart from the cost of capital onto that, then depending on what they meant by interest then and I don't think they just meant cost of capital, you are actually loading it up to start with and prepaying it and as I say then loading it into the thing and paying interest on the prepayment of interest.

MR GODDARD QC:

And that's where understanding the cost structure is important and that's why unsurprisingly it's a mandatory relevant factor when it comes to considering this because what you're effectively asking is, is this a cost that is proportionate to the amount advanced because otherwise –

GLAZEBROOK J:

No, no I'm not. Well I'm not asking that.

MR GODDARD QC:
No but in my submission one ought to.

GLAZEBROOK J:
I'm saying to you that I'm not convinced that the only thing they say should be taken into account in interest in the prohibition on prepaying interest is everything other than the cost of capital and a margin which is the result of your argument.

MR GODDARD QC:
The prohibition on charging interest in advance is designed to ensure that the interest rate that is disclosed and it's a mandatory disclosure item, accurately reflects the rate at which you will pay for the use of the money over the life of the transaction and the reason for prohibiting charging interest in advance is not to attempt to regulate substantively how much interest is recovered, that's a matter that's dealt with under the oppression regime otherwise it's not regulated, it is to ensure accuracy of disclosure of the rate, that it's comparable and meaningful. In order to achieve that, what you need to ensure is that amounts that are referable to the value of the advance, to the amount of the advance, and to the use of that money over time –

GLAZEBROOK J:
If you don't have a finance rate it's meaningless whether you are accurately disclosing what you do without prepayment isn't it? Because you're not disclosing. If you're allowed to load absolutely everything up front without the disclose of a finance rate then the fact that are give an accurate thing of your five percent that you pretend is the interest rate, when in fact it's not what you're getting for lending because you've loaded it all into fees, then it's not an accurate disclosure is it?

MR GODDARD QC:
The way that the disclosure works is to say first of all there must be accurate disclosure of the price you pay for the use of money over time and that you have to the state the interest rate in a particular way which was not the requirement under the previous legislation. It has to be an effective rate relevant to what's charged on the daily balance. Second, if you're going to charge anything else, then that's called a fee under the Act and you have to disclose it and it must be reasonable which means it must be in a reasonable relationship to the matter that it's described as relating to.

If it is in fact a charge for the time value of money which is the concept of interest that underpins this Act and that is of very long standing, then it is likely, I'd say almost certain that it will be unreasonable to recover it through a fee.

GLAZEBROOK J:
So you are indicating exactly what I just said to you right at the beginning after that long explanation, that what you say is that what this means here is interest is only time value of money?

MR GODDARD QC:
Yes.

GLAZEBROOK J:
So it's your cost of borrowing plus a margin.

MR GODDARD QC:
No it's the cost to the borrower of the money over time. That's what you're disclosing.

GLAZEBROOK J:
Well that's – oh never mind, I think we're talking at cross-purposes probably and it's probably not much point.

MR GODDARD QC:
Let's then continue on down to, well to pages 7 and 8 and we see a discussion of interest charges beginning at clause 34. It's the limit on interest charges and the way that that's done is by saying the amount, the maximum that can be imposed is the amount determined by applying the daily interest rate to unpaid daily balances and then regulation of default interest rates on 35. 36 which became section 41, provides that a consumer credit contract must not provide for a credit fee or default fee that's unreasonable. The Court may annul or reduce any fee that is unreasonable. This provision is similar to section 72 of the Consumer Credit Code, the Australian one. I will come to that, time permitting, later.

Then clauses 37 to 39, our 42 to 44, give the Courts guidance as to whether a fee is unreasonable in any particular case and we see a description of 37 in relation to establishment fees and as it says at the foot of that explanation which otherwise

really just tracks the language of the provision, "The test is designed to ensure that creditors match fees to the specific cost of the matter giving rise to the fee." 38, prepayment.

ARNOLD J:
Just stopping there, don't the words "specific costs" operate against your rule review?

MR GODDARD QC:
Specific cost of the matter at least I think is consistent with the avoidable cost test because what is the specific cost of the matter, it's the activity in question. I think you're right Sir to say that it is points more against than in favour of the argument that a contribution to common costs can be recovered in that way. The explanatory note is not flawless and there is one obvious problem with it which will I think immediately be part of it Your Honour when we come down to clause 39. Just here we've also got a reference to ensuring that creditors match fees to the specific cost, which is something that the Commission understandably emphases in its argument.

When you look at clause 39 what you see is, "Matters that must be taken into account to determine whether any other credit fees and default fees are unreasonable. The test set out in the clause is designed to encourage creditors to match fees to specific costs." So you've got "ensure" in 37, "encourage" in 39 but you've actually exactly the same language of "have regard to" in the operative provisions in both, so it's not entirely or it's not easy to understand what distinction was sought.

GLAZEBROOK J:
Well you've got that commercial practice there, so that might be the issue.

MR GODDARD QC:
I was about to say the only distinction one can point to is really that B, which still takes us back then at least to the fact that in relation to other credit fees and default fees there is intended to be a more flexible approach.

And then what I wanted to come across to in this explanatory note after drawing the Court's attention to those pages was the, again just in terms of pricing flexibility, the regulatory impact and compliance cost statement which is included in the explanatory

note, as of course it now must be. So on page 19, statement of the problem and the need for action, the concerns for the existing framework are set out and then over the page, page 20, statement of the public policy objective, "regulation of consumer credit has clear goals, couldn't be achieved without government intervention as there are key elements of the market failure identifiable with consumer credit as well as equity problems. The goals are to one, promote efficient credit markets." So efficiency is a goal, it's not the only goal but it is a goal. "Second, provide for effective information disclosure and the need for consumers to be informed and to distinguish between products identified."

But then third, allow pricing flexibility for lenders. So that was also a goal and as we'll see when we come to the detailed policy papers that preceded this, it was absolutely understood that there's a tension between the second of those bullet points and the third, that the more flexibility lenders have in terms of the types of fees that can be charged and the ways in which products are structured, the harder it's going to be to compare those products, doing apples for apples comparison and I gave the example earlier of buying a motorbike, do I buy it on a contract like this, a tailored one with fixed payments for a defined period, do I put it on my credit card or do I put it on my revolving credit facility secured by my mortgage? What the balance that was struck was to say we don't want –

ELIAS CJ:
Sorry, the pricing flexibility.

MR GODDARD QC:
That's as between fees and charges in particular.

ELIAS CJ:
Well why do you say it's as between fees and charges from this explanatory note?

MR GODDARD QC:
First because –

ELIAS CJ:
Why isn't it just the fact that prices aren't regulated?

MR GODDARD QC:

They weren't of course before and –

ELIAS CJ:
No but why – how do you make that connection?

MR GODDARD QC:
That, first of all I would've thought was, when you talk about flexibility in pricing for lenders, they're either charging an interest charge or by definition it's a fee. Anything that's not an interest charge is a fee.

ELIAS CJ:
Well why isn't it just what they charge for interest?

MR GODDARD QC:
I would've thought that would more naturally be expressed in other ways, not limiting the amount of interest charged, whereas this is a much broader concept, pricing flexibility and when we look at the legislative history again it's absolutely clear that that's what was intended. So let me go to that, I keep promising that. I'm like a preview on Apple TV that's stuck and you never get to see the movie. So for better or worse let's go to the movie.

I was going to take the Court and this is in my 3.1, to the first scene setting paper which is under tab 18 but I think, given the passage of time, I should cut to the paper that deals explicitly with fees which is the part 3 paper, 3 of a total of 5, which is under tab 19 and there is –

O'REGAN J:
This isn't really a parliamentary paper is it?

MR GODDARD QC:
No it's a –

ELIAS CJ:
Is this a Ministerial?

MR GODDARD QC:
This is the consultation that led to the legislation.

ELIAS CJ:
We don't normally look at these.

MR GODDARD QC:
It's a public consultation paper that defined the policy concerns and led to the legislation. So it's just like a Law Commission paper.

O'REGAN J:
No it's a departmental paper. I mean there's quite a lot of authorities that say you don't look at departmental papers.

MR GODDARD QC:
They say that you don't look at departmental reports to the Select Committee for example and that's right because it's not a publicly available –

ELIAS CJ:
No it's wider than that.

O'REGAN J:
But it's not a parliamentary paper is it?

MR GODDARD QC:
There's never been, in relation to identifying the mischief at which a legislative instrument was aimed, a restriction on looking at reports which identified that mischief. So if Your Honour thinks for example of the contracts and commercial law reform committee papers which was just a committee established by the Ministry of Justice to look into various contract law issues and credit issues, that's always been considered when seeking to understand Contractual Remedies Act 1979, Contracts (Privity) Act 1982, other legislation that dropped out of.

O'REGAN J:
Yes but that's not a departmental paper giving advice to members, is it?

MR GODDARD QC:
Well, it's a committee established by Ministers to give them advice.

O'REGAN J:

Yes but it's the same as the Law Commission. It's just a forerunner of the Law Commission and the Law Commission is different. It's a law reform body. I thought there was quite a bit of authority that said departmental papers don't usually inform. Parliamentary papers do but not departmental papers.

MR GODDARD QC:

I mean, I'm happy to come back with some detailed material on that tomorrow but that's certainly not my understanding of the established position.

ELIAS CJ:

Well, it's my understanding.

MR GODDARD QC:

One of – at first instance there was material referred to in this context such as some Cabinet papers which is plainly inadmissible and irrelevant in this Court.

ELIAS CJ:

But this is even more remote from the Parliamentary process.

MR GODDARD QC:

I don't – in time, yes, but in terms of being –

ELIAS CJ:

No, no, in terms of legitimacy and authority.

MR GODDARD QC:

In order to understand what the mischief was –

ELIAS CJ:

No, it's got to be discerned from Parliamentary – well, it's principally from the legislation itself. All of these are exceptions that are of relatively recent date and have been quite narrowly looked at. In fact, as you would know, there are schools of thought that actually we should turn back the clock.

MR GODDARD QC:

Yes and that in my submission – well, first of all that is not today's issue. I don't think anyone's arguing that but in my submission that would not be a sensible approach to take.

ELIAS CJ:

Well, do you want to take us to *Hansard*?

MR GODDARD QC:

Let me go, then, to *Hansard* but what I will do is adopt some of the analysis in that paper as effectively submission because I think it puts it well and I didn't go to it because I was going to – but let's go to *Hansard* which followed on from the explanatory note, the reference to pricing flexibility, and then I'm going to come back to the analysis because it is, in my submission, helpful even if it's nothing more than submission adopted by reference. So the *Hansard* under tab 21, what we've got here is the first reading of the Bill and the Minister's introduction speech and over the page after setting out the history of the old legislation and the difficulties with it says about 12 lines down, the Minister says, "I'd now like to outline and explain the key features of this Bill. The purposes of the Bill are to protect the interests of consumers in respect of credit and consumer lease contracts to enable consumers to become informed and to provide transparent rules for charging interest and fees and calculating balances and aims to prevent oppressive conduct."

Then the next paragraph down, "The Bill maintains a requirement on credit to disclose information about the credit contract to consumer borrowers and items required to disclose have been updated. Notably lenders are no longer required to calculate and disclose the finance rate. The finance rate provision was not as successful in practice as it was initially hoped and made the Credit Contracts Act unnecessarily complex while adding a layer of compliance costs."

In short, that's because to attempt to reduce the cost of credit to a single number, an AFR was in some cases simply impossible and in other cases misleading. The reasons for that are explained in the paper to which I referred a moment ago.

Then we come down to the next paragraph. The Bill adopts Australian provisions that prevent creditors from using various unfair methods of charging interest and calculating balances. For instance, interest cannot be charged in advance. Creditors

will also have to cease using unfair methods to calculate early settlements. The Bill also ensures that creditors cannot charge fees that are in the nature of interest as a means of avoiding the restrictions on interest charging, so again we've got that linkage between the two regimes.

That's about as much help as we get from the *Hansard* but let me …

GLAZEBROOK J:
Which is just the repetition of the explanatory note, isn't it?

MR GODDARD QC:
Yes it is really. I take the Court to what I think is quite a helpful explanation of the choices that our legislature had in deciding which model of the various international models to adopt and follow and it's quite clear that a choice was made to adopt the Australian model. We see that in the references in the legislation to certain provisions of the Australian code and very close structure or similarities between sections 41 through 44 and section 72 of the Australian code and in the consumer credit law review consultation document, after setting the scene there is an identification, I'm going to go to page 3.

ELIAS CJ:
Where are you now?

MR GODDARD QC:
Sorry so now I'm under tab 19.

ELIAS CJ:
Well what's the submission you want to tell us?

MR GODDARD QC:
Okay, so the submission that a conscious choice was to adopt what was referred to in this paper as a synthesised approach based largely on the Australian model which abandons an annual finance rate which we used to have because attempting to convey the cost of credit to consumers through a single figure is not only impossible in some cases but misleading often and there's a very helpful analysis which if I had 100 page sort of, you know, page limit in my submissions here I would have repeated

about just how unhelpful and misleading that can be, how impossible it is to have a meaningful figure in relation to some sorts of transaction.

Next the submission is that the possibility of following some overseas models and either prohibiting fees completely which is an approach that's been considered in a number of jurisdictions and adopted in some or of limiting the types of fees. So you can have establishment fees and default fees but no other fees for example, was explicitly considered, the pros and cons canvassed and it was rejected and that's why we don't see it in our legislation. So there are overseas models that take that approach. We chose not to go down that path and one of the key reasons we chose not to go down that path was because first of all it limits the flexibility of pricing as between interest and fees, it's explicitly explored which can enable consumer –

ELIAS CJ:

What's the submission that you make? The submission that you make is what, that the legislation –

MR GODDARD QC:

Consciously chose not to limit the types of fee, consciously –

ELIAS CJ:

Well it doesn't limit the type of fee. I mean on its face it doesn't limit the type of fee. So you're pushing at an open door. It still leaves open the question of what is reasonable fee and as you've accepted that relates both to the fee itself and to the extent of the fee.

MR GODDARD QC:

And the next limb of the submission is that the idea that transparency would be advanced by pushing all or most of the cost of credit into the interest rate rather than fees is not a feature of our legislation. That possibility was expressly considered, it was rejected and related point, it was, and I can make the submission both as a standalone submission and by reference to legislative history, there is no gain in terms of comparability by limiting the types of cost that be included in particular fees if fees of that kind are permitted. In other words if you can have an interest charge and fees A, B and C, then you don't achieve any gain comparability between products by regulating whether, you know, you have a narrow closely connected set

of costs in each of those fees or a broader set of costs. Comparability is achieved by disclosure of those amounts.

The reason to impose regulation by reference to a reasonableness standard is effectively two-fold. It's first to avoid recovering interest costs through the fee in circumstances where interest charges have been regulated in the light-handed way I ran through in the statute and second, to ensure that consumers understand the matter to which the fee relates and there is an ability to challenge a fee where there is no reasonable relationship between the matter to which the fee relates and the charge and the fee but that there was no additional objective of making them smaller rather than larger for example and that's because, even on the Commission's approach, if your variable costs are high you can charge that high amount. So you can have all those different fees, you can different levels of fee. The comparison has to be done anyway. So I guess, Your Honour, that takes me to –

O'REGAN J:
So what's the point of having high fees then? Why does MTF think it's better to have high fees than low fees?

MR GODDARD QC:
To answer that, one is that it's always better to have an efficient pricing structure, rather than an inefficient one and that if you have a lower interest rate and higher fees and if that tracks more closely your costs of providing the service, then you are likely to be able to serve people for whom the cost of funds is a more acute consideration. You're not disadvantaged in a market to serve people who are borrowing more or for a longer term. I suppose, I mean that's one reason. It's efficiency.

O'REGAN J:
But I mean in this case consumer car finance is all short term isn't it? There isn't variable, I mean it's –

MR GODDARD QC:
Between one and three years which makes quite a difference to cost of credit actually and it's one of the key dimensions which –

O'REGAN J:

Is there any evidence on the term, the terms of their funding?

MR GODDARD QC:

Yes there is evidence on how long they're initially advanced for and how many run to full term and I think which is about 75% I think and how many are repaid early. I'd have to get the detailed references but there is evidence on that and perhaps, again more importantly, yeah it's really all about trying to come with a package.

O'REGAN J:

That didn't seem to be what was motivating them when the Act came in though. I mean they were talking about having an opportunity to make greater profits out of charging fees rather than sending more efficient pricing signals to the market.

MR GODDARD QC:

The opportunity to rebalance between fees and interest costs was certainly identified but as the evidence shows and I deal with this in my annexure, it was the position and Mr Cregten ultimately accepted in cross-examination that the rebalancing did involve backing more per dollar advanced out of interest than went into fees profitability in the sense of the amount of profit per dollar of turnover fell as a result of that rebalance and that was seen as a –

O'REGAN J:

But that seems to be an accident rather than intended, doesn't it?

MR GODDARD QC:

No Your Honour it was a deliberate competitive strategy.

GLAZEBROOK J:

You mean they deliberately decided to take less profit?

MR GODDARD QC:

No they deliberately decided to reduce their profit per dollar in order to build their business book and that was successful and that's why Mr Cregten initially misunderstood the position. There are two reasons why Mr Cregten's initial suggestion that there had been a significant additional profit from fee income was

wrong, one was confusion about the tail of pre CCFA contracts and how that was accounted for in the accounts but the other reason was that this was an attractive offering in the market and the overall size of MTF's book grew substantially, so its gross profit –

O'REGAN J:

Was that because the market thought the interest rate was really low and didn't realise they were having to pay in fees?

MR GODDARD QC:

It was because the overall – well I mean the evidence again was that it's in the context of this type of credit there tends to be an emphasis on the weekly or monthly amount you have to pay and that was competitive and there's certainly no evidence to suggest that anyone was misled by this fee structure and of course the cause of action under the Fair Trading Act brought by the Commission was dismissed at first instance and there's been no appeal from that, so the suggestion that –

GLAZEBROOK J:

It was quite a limited action though on the Fair Trading Act 1986 wasn't it, in the High Court?

MR GODDARD QC:

Suggesting that consumers were misled by the description of these fees as relating to certain matters because they exceeded costs basically.

GLAZEBROOK J:

Exactly it was a very limited – it wasn't the more general point that's just been put to you?

MR GODDARD QC:

No.

GLAZEBROOK J:

The action sorry wasn't the more general point.

MR GODDARD QC:

But nor would it be right to assume in circumstances where that was neither alleged nor established that there was such a problem and again I think it is helpful to go back and remember that the opportunity for MTF to make advances depends entirely on persuading dealers who are trying to maximise their sales that this is the best product in order to get the product following out of the showroom. So they face a competitive restraint in a business to business market. So it would be odd if they were, yeah, trying to do anything other than persuade their immediate customers that this was the best possible mechanism for coming up with overall low effective cost financing of vehicles.

O'REGAN J:

So is it MTF's case that if it had to lower its fees that would mean a higher overall cost of credit to consumers?

MR GODDARD QC:

MTF's case is that if it lowered its fees it would increase its interest costs and that would mean that consumers paid more and others paid less and the question then is, is that a more reasonable outcome?

WILLIAM YOUNG J:

So who would pay more, who would pay more? Those who borrow large sums of money spread over a lengthy period of time?

MR GODDARD QC:

Yes either higher amounts or longer periods because if you bundle the recovery of certain costs, especially forward and budgeting, into your interest rate, then the people who borrow $20,000 for a year, will other things be equal, pay twice as much as the people who borrow $10,000 and yet the cost of writing the loan for them is not different.

WILLIAM YOUNG J:

But is it the same? What was the evidence as to that? Was there evidence on that point? I mean it might be that more attention would be paid to a $20,000 loan than a $10,000 loan.

MR GODDARD QC:

There was – I need to go back and check whether there was any evidence that that wasn't the case and I'm pretty confident there was no evidence that that was the case. It may just have been assumed that the cost of doing a credit check on a person, the cost of the time spent filling in the paper.

GLAZEBROOK J:

But we're not talking about – because the Commission accepts that those specific amounts that are specifically related are allowed to be charged as fees. What we're arguing about is the managing director and the training and everything else which is quite different from the specific amounts isn't it?

MR GODDARD QC:

Well the training costs is –

GLAZEBROOK J:

I'm using that as an example, please just don't go back to that.

MR GODDARD QC:

No, no.

GLAZEBROOK J:

I'm saying you say that everything gets lumped in rather than – and I shouldn't have even mentioned training I'm sorry because nobody is suggesting that the specific costs that you just talked about are not able to be charged.

MR GODDARD QC:

Yes they are, the training costs. So you mean the other ones.

GLAZEBROOK J:

No I'm not talking about training costs, the ones you just mentioned.

MR GODDARD QC:

No, no sorry the documentation ones, yes. But then the questions becomes, sorry Your Honour –

ELIAS CJ:
The establishment costs you're talking about aren't you?

MR GODDARD QC:
We're talking about establishment fees and what can properly be included in establishments fees. There's also issues about, you know, we get to the same thing in relation to default. It's not, I know Your Honour expressed regret about having gone there but if we're asking how costs like training the people who approve loans should be recovered, then it is at least a reasonable view that just as the time spent processing the loan doesn't vary with quantum, at least within some sort of range, I think Your Honour is right but once you get to a high value obviously you're going to put more effort into it but within quite a large range you're going to spend the same sort of time processing the loan. Similarly –

ELIAS CJ:
Why is it either/or? Because if you look establishment fees under 42, there's an indication there really of what is reasonable. You either charge a fee equal to your reasonable costs in relation to that application or you can charge the average reasonable cost for the appropriate class of consumer credit contract. So you can segment according to –

MR GODDARD QC:
Yes and the question then is what costs in terms of that analysis you take into account in doing your averaging and the submission I was making was that where you have costs that do not vary materially depending on the amount advanced, then it is reasonably open to a credit to conclude that it is appropriate and it is, in my submission efficient to charge those through a flat fee rather than in an interest rate that is proportionate to the amount advanced.

WILLIAM YOUNG J:
Could you not, I mean these are random thoughts really, could you not say that the interest rate for a $20,000 will be seven percent, the interest for a $10,000 loan will be eight percent and pick up the differential costs in that way?

MR GODDARD QC:
Yes you could and again what we're back to is the question of whether what you want to see is a graduated set of interest rates for different amounts or whether the

cost is essentially a flat cost per loan rather than a cost that has a close relationship with the amount advanced or the time out, it's not simpler to charge a fee and what this legislation does is say this is something we will leave to the market. Normally we don't.

WILLIAM YOUNG J:
You see it would be – I mean if you are someone who is thinking of borrowing $20,000 to buy a car and you're looking at the finance arrangements available, it would be a jolly sight easier to compare if as little as possible were put in the fees category and as much as possible were put in the interest category because then you would be largely comparing apples with apples.

MR GODDARD QC:
That's an assumption which really underpinned the idea of either prohibiting fees because you then end up with everything charged through interest. That takes that to its logical conclusion, so you can't have fees, we'll just have interest rates, recover everything through interest, clearly not the policy choice, or which takes you to limiting the types of fees charged, again clearly not the policy choice.

GLAZEBROOK J:
No what they say they limit the amount of fees charged which is a policy choice that fits very well into what Justice Young just put to you.

MR GODDARD QC:
And then we need to understand what that limit was and what its purpose was and it's not driven off a small fees are good assumption because that aids comparability. Let me tackle that because as I said earlier that seems to me that that's an assumption which underpinned –

ELIAS CJ:
Sorry are you saying that left it to the market but it hasn't because it's established a standard of reasonableness. So ultimately that's one that has to be assessed.

MR GODDARD QC:
So Your Honour is quite right, I oversimplified and that's a risk in an area where you're balancing policy goals and I fell into that trap. What had to be decided in enacting this legislation was how much left to the market and how much to regulate

and the possibility of saying to the market well you can't charge fees was rejected, the possibility of saying to the market you can only charge particular types of fee was rejected. A conscious choice was made not to limit types of fees, but what was said was, where you do charge a fee you need to describe what it relates to in the disclosure and it must be reasonable, and that general standard was left to be applied with a certain amount of guidance in relation to mandatory relevant considerations in sections 42 and 44 with a definition of what's reasonable for prepayments in 43.

So a balance was struck, but that balance was not driven by an assumption that no fees is a good thing. It enhances comparability because all you've got is interest rates, Your Honour, Justice Young's point but at too much of a cost in terms of flexibility in offering different packages to different borrowers with different needs, different preferences. Nor is there any room for an assumption that a rule like variable costs should be applied enhances comparability because variable costs can differ enormously and can differ enormously depending on business structure decisions that are completely invisible to, and irrelevant to, a consumer.

The question of whether a retailer, for example, borrows back to back and passes on the fees they are charged by a commercial lender, whose fees are not recovered by this, or does some of the functions in house, is not a choice that one would have thought should be influenced by the form of regulation of the consumer credit contract and there are –

GLAZEBROOK J:

Is it your submission that if you're charged something by somebody else and pass it on without changing it that there is no regulation of the amount of that fee and it's not limited by reasonableness?

MR GODDARD QC:

No, as I submitted earlier section 41 still applies as well as section 45 –

GLAZEBROOK J:

Well, then the choice makes no difference does it, because if you are looking at reasonableness in that context as well, then it is actually a matter of indifference to the consumer but not in terms of the assessment of reasonableness.

MR GODDARD QC:

If what one has is a charge in a commercial lending transaction which is competitive and which is efficient in the sense that it doesn't involve any element of supra normal profits, initially raised by the Commission, but one which I think in practise is unlikely to arise in that context, then it will almost always be reasonable, in my submission, to pass it on. And that fee will include an allowance for all the costs incurred by the lender in providing that service to the retailer, including their full costs of ownership of all the relevant assets used to provide the service and a contribution to their fixed and common costs.

GLAZEBROOK J:

So you're basically saying they can charge what they like basically.

MR GODDARD QC:

Well they certainly can and then the question –

GLAZEBROOK J:

Well, I mean of course they can charge what they like. It's just in terms of whether that would be reasonable to pass on to the consumer in terms of an establishment fee, and that can only be the case if the initial lender, themselves, is able to pass on those, otherwise it's not an argument is it?

So if you say, well, if you limited it to variable costs for the immediate lender, they would immediately go and contract it out and then pass on the whole lot of the costs.

MR GODDARD QC:

And I don't understand.

GLAZEBROOK J:

And that would be perfectly fine from everybody's point of view.

MR GODDARD QC:

And in circumstances where the fee is a –

GLAZEBROOK J:

But that's not an argument to then say, oh, well, therefore they ought to be able to pass on all of their costs is it?

MR GODDARD QC:

The starting point for the argument is that if a retailer like Sportzone goes out into the market and gets lots of bids from lots of different potential sources of finance to Sportzone and takes the best offer available to it across all dimensions and then passes on that mix of fees to their customers, there is no reason to think that there is any unfairness, unreasonableness, distortion in any of those fees because all the incentives are appropriately aligned. And if you pass on a reasonable fee charged in a competitive market without – you wouldn't assess that by doing a detailed analysis of the upstream financiers cost.

GLAZEBROOK J:

I don't really understand about how the incentives are aligned there because just because somebody has chosen to split it between interest and fees on a wholesale market would, therefore, mean it was totally reasonable to pass those on in a retail market, because if you're talking about going out to get financing, then you're going out to get financing on a wholesale market and it's a matter of indifference, absolute indifference I would have thought, to the person who's getting that wholesale funding. How that is worked through, whether it's called fees, interest or something totally different, what they're interested in is their cost of funds. And then so that if you allow them, then, to pass on what's the total matter of indifference in the interest of efficiency.

MR GODDARD QC:

The scenario I was talking about what the scenario where you have back to back loans to finance the provision of credit to particular customers, which is a very common form of financing in many, many markets. And if you were going to pass on those costs in order to finance sales of your produce, what you sell at retain, you want your product at retail to be as attractive compared with all the other suppliers of comparable product as it can be, which means that you want to offer the most attractive package, including finance, to your customers, that you can offer. That's what I meant by saying incentives were aligned, that the retailer is effectively trying to procure, has a strong interest in procuring an attractive cost structure that will enable them to sell more motorbikes or more pianos or whatever it is they're selling. And

there's no, there's not the same concern about market failures and information asymmetries in that commercial market that exists downstream.

So it would normally, I would say almost invariably, be the case that you would expect the passing on of fees, resulting from a transaction of that kind to be reasonable and, more importantly, you wouldn't naturally, in enquiring whether that fee was reasonable, embark on an analysis of the ultimate lenders, the bank or whatever's, internal costs of providing credit. That, it seems to me, would be a peculiar way to approach the question of whether it was reasonable to pass on the fees that were being charged. You'd focus rather on the process I've just described. If that's right and, in my submission, it is, and it's consistent with the structure of the legislation, then it makes sense to treat the costs that the retailer would incur if they took on some, or all, of those functions themselves as equally connected with the matter in question.

It shouldn't matter whether you pay someone else to engage in the activity and pay them for all the capital and assets they devote to that, and the time they devote to that, or whether you do it yourself. Broadly speaking, the same bucket of costs are still connected with that matter and are mandatory, relevant considerations under sections 42 and 44.

O'REGAN J:
You wouldn't be likely as a business to contract out something to someone else that would make your ultimate product more expensive, would you?

MR GODDARD QC:
Precisely.

O'REGAN J:
Why would you do that?

MR GODDARD QC:
No you wouldn't.

O'REGAN J:
Well, so, why are we worried about it? I mean MTF isn't going to say because the Court of Appeal has said we can only charge fees based on variable costs, we're

going to contract out all our administration to someone else and then lumber a bigger cost on our customers and make ourselves uncompetitive. Why would they do that?

MR GODDARD QC:

It's not about a bigger total cost. It's about the most competitive structure of costs, point 1. Point 2, I think it's helpful to think about it the other way around. Suppose that you are currently buying in some service at a per contract rate and you decide that you think you can do it cheaper and lower your costs and offer a better deal to your customers. Then my submission is that all the costs you incur in order to be able to do that, all the costs that as a rational business you would take into account in working out whether you could do it more cost effectively should be able to be included in the fee.

So if you're buying in the service of processing applications and considering them and you form the view that you can do that more cost effectively then you will have sat down and have said, well, I'm going to save the X dollars per contract I'm paying whoever it is, what is it going to cost me and you will look not only at your variable costs but also obviously at the costs over time and over a predicted number of contracts that you will incur in taking on extra premises in hiring extra staff, not just paying their salaries but having the HR department hire them and training them to do the job in providing them with desks and computers, all those things, and if, having looked at those costs, you work out that instead of paying someone else $100 per contract to do it you can do it at $90 a contract factoring all that in, then in my submission it is desirable from a policy perspective that you make that choice and it is perfectly reasonable for the purposes of this legislation that you charge $90, even though that includes an allowance for training costs, even though it includes an allowance for owning desks, even though it includes an allowance for owning computers. That's the commercial calculation you carry out. You've worked out a better, smarter, cheaper way to do it. Why shouldn't you (a), be encouraged to do it and (b), be able to just flow that through into the fee?

O'REGAN J:

But why are you discouraged from doing it? Because even if you can't put into your fees you'll have a lower interest rate, so the weekly payment your customer has to make will be lower and your dealers will say MTF are even better now than they were last week because they're now offering a combined package of fees and interest which are lower than they were last week.

MR GODDARD QC:

But the Commission’s case approved by the Court below is of that $90 you would be able to recover maybe 40 or 50 in fees.

O’REGAN J:

Well you just put the rest in the interest rate, what does it matter?

MR GODDARD QC:

Which means your interest rate goes up.

O’REGAN J:

Yes but you’ve just said it doesn’t matter because it’s the weekly payments are actually what the market’s looking at and the weekly payments would go down.

MR GODDARD QC:

But if what you're doing is investing in reducing the cost of something which is effectively a flat per contract cost, not a cost which is proportionate to the amount advanced, and if you believe that one of the important dimensions on which a comparison takes place is interest rate, it needn’t the only one or even the main one but if it’s an important dimension you may see it as competitively undesirable to be seen to raise your interest rate in the market, particularly if you’ve got a market, you know, where interest rates are falling otherwise and you're raising yours, people will say, “Well why has it gone up and why is now higher? Why is Goddard Finance Limited or Goddard Motorcycles Limited, charging more than Mills Motorcycle Limited?” Which I must say sounds better and there is no reason identified in the Commission’s submissions identified in the judgments below, why it is unreasonable, why it is contrary to any policy objective pursued by this legislation for Goddard Motorcycles or Goddard Finance to make that investment and then charge $90 while holding the interest rate constant. Your Honour is exactly right that there is an option to do something else but the question is does the legislation prohibit doing what I’ve just described and why?

O’REGAN J:

But even on your measure the same incentive applies doesn’t it? Because the third party is going to include a profit margin which on any measure you wouldn’t be able to include if you're doing it in house. So I mean the incentives are there, it’s just a

question of how big they are on any analysis isn't it? I don’t think that is something that should drive the interpretation of the legislation. There are anomalies in markets, that’s just the way life is. This is an industry where the legislature has said the test is going to be reasonable, not something else. I mean it could have set full cost recovery but it didn’t.

MR GODDARD QC:

And the nub of my submission is why would one limit the factors that go to reasonableness in a way that produces that anomaly. The language is brought. The language can be read in either of two ways. Reasonable people can and do disagree about how best to read this text and how best to apply it. It depends really on an understanding of what you're trying to achieve. If you can read it in a way which doesn’t produce that anomaly and which ensures that if you are competing on more efficient ways to do something which currently is recovered through a flat fee, you can put your full cost of doing that thing still into a flat fee, why wouldn’t you go down that path.

O’REGAN J:

Yes but what we’re talking about is the whole market operating under these rules. So if everyone is operating under the same rules it doesn’t matter does it?

MR GODDARD QC:

It does if you’ve got people with different business models competing against each other and it’s particularly acute and one of the ironies of the approach approved below is that it is particularly – it produces particularly strange outcomes in relation to increased computerisation of the provision of services which in this market, as in many markets, seems likely to be a path to delivery of more responsive, more desirable services to consumers but that tends to involve capital investment and then very low variable costs.

O’REGAN J:

But surely you're not saying that a finance company would say we could be much more efficient and offer a much cheaper product if we computerise but we’re not going to do it because the Commerce Commission won't let us put it into our fees. I mean if they're going to offer a better product they will do it, won't they? People do respond to those incentives in a rational way and if their overall costs of business are going to be lower of course they’ll still do it.

MR GODDARD QC:

That depends on whether they are constrained by this regulatory regime to charge for the improved service in one way rather than another. I think there's a measure –

O'REGAN J:

But you're not going to have voluntary Luddism just because you want to charge higher fees.

MR GODDARD QC:

Not because you want to charge higher fees but possibly because you don't want to charge higher interest rates. There's no doubt but that as the – I mean the process by which evaluate credit contracts is not perfectly understood and it has a measure, you know, idiosyncratic and imperfect values in it. I don't think that's controversial, that's partly that information asymmetry and processing difficulty that produces regulation. A number of things are very important. MTF believes that the most important thing is the weekly or monthly payment but the headline interest rate is also important. The Commission seems to emphasise rather more the headline interest rate and perhaps rather less the periodic payments. I don't think the Court needs to answer that question. The point is that if both are relevant then yes of course it's desirable to make a investment that reduces the weekly payment which is a synthesis of the two things. I'll come back to one slight variant on that.

ELIAS CJ:

I'm just really wondering where all this discussion about policies that might or might not be sensible to picked up in legislation, I really wonder whether you shouldn't just be grounding it much more on the legislation we have. It may not be the best bit of legislation but we've got to try and make sense of it.

MR GODDARD QC:

We do and the only reason I'm spending time on this reason is to suggest that in the process of trying to make sense of it –

ELIAS CJ:

Yes don't do something that's not sensible.

MR GODDARD QC:
Yes which is not a very –

ELIAS CJ:
And construe it to give –

MR GODDARD QC:
And to avoid anomalies if we can.

ELIAS CJ:
Yes, no I understand that.

MR GODDARD QC:
So if it's possible to avoid an anomaly without giving rise to any policy concern that is reflected in the legislation, other things being equal that's a sensible thing to do and what I've attempted to do in my submissions is to identify a number of anomalies that arise on the approach adopted below which in my submission are easily avoided by taking a broader more flexible approach to two things. First, which costs you take into account. You don't artificially narrow that to a set of costs narrower than the cost that would be taken into account by someone when deciding whether or not to engage in the activity or whether to contract it out for example or how to engage in an activity, whether to do it manually or by automation.

If you're making a choice between those, you should be able to choose the cheaper one and pass on the full cost of that in your fee. It shouldn't surprisingly produce the consequence that depending on how you choose to do it people with pens or technology that suddenly what can be a fee drops down and what has to be in the interest rate pops up. That's just irrational. Why would you go there unless there was a good policy reason to do so and that's why I have then looked at the policy objectives to say there is no policy reason. There is no policy case for saying that that broader set of costs, the costs that from a business, common sense perspective, are incurred in order to undertake that activity, in order to do that matter should not be passed on, so that gets you to at least the avoidable costs.

Then you get the question of whether a broader range of factors can be taken into account and there again the submission is that in normal day-to-day commerce prices, fees, other forms of price by a supplier will recover a contribution to fixed and

common costs. What is there to suggest that what is normal and reasonable elsewhere is unreasonable?

ELIAS CJ:

All right. Well, can I take you to the text because I do have a question concerning it. Again going back to sections 42, 43, 44, they're all concerned with credit fees but make specific provision for establishment fees and prepayment fees and then the others are provided for. Is there significance in the fact that in the case of establishment fees and prepayment fees, the legislation permits an averaging of reasonable costs and averaging reasonable administration costs, or sets a formula, but it doesn't mandate that in relation to other credit fees.

MR GODDARD QC:

And default fees.

ELIAS CJ:

And default fees.

MR GODDARD QC:

In my submission, the ability to average is brought in, in that context, by the reference to reasonable standards of commercial practice, which is broader –

ELIAS CJ:

Yes, except that that's not a stand-alone and it follows – you have to read the whole thing, and 44 is about the matter, as we've said, giving rise to the fee and then it's referring to a service, if the fee relates the provision of a service but it's specific. It seems – section 44 seems pretty specific to the actual costs for which the fee is being charged. Why is it necessary to the legislation to refer specifically to average reasonable costs in relation to the two other sorts of credit fees?

MR GODDARD QC:

The – what we see in relation to establishment fees is explicit contemplation, either of a tailored cost recovery or of an averaging approach.

ELIAS CJ:

Yes.

MR GODDARD QC:

And so you're not required to do it individually and I suspect you're also not required to average. You can say to a particular high cost transactor –

ELIAS CJ:

Yes, you can say you're a high cost, yes.

MR GODDARD QC:

Yes, and I'm going to recover the cost of valuing your unusual asset from you.

ELIAS CJ:

Yes.

MR GODDARD QC:

When it comes down to prepayment fees, it, I think, is reasonably clear that the loss arising from prepayment in terms of foregone profit, foregone income actually does need to be tailored. It's the administration costs that there's reference to averaging.

ELIAS CJ:

Yes.

MR GODDARD QC:

And that's because you have different interest rates in different people's contracts and you can, and reasonably should, do a creditor by creditor calculation of the foregone profit element in the transaction. When it comes –

ELIAS CJ:

But why is it necessary to make those specific references if in other credit fees you can simply have the course to that methodology on your argument as I understand it?

MR GODDARD QC:

And that I'm not – it's hard to carry too much of a torch for the drafting of these provisions.

ELIAS CJ:

No, it's a terrible bit of legislation.

MR GODDARD QC:
And I wouldn't – and what one also sees is a lot of influence of the Australian provision. Itself no creature of beauty in the language used here. So I think part of it's – the answer is partly history. But –

ELIAS CJ:
Well, so, do you say it doesn't matter because in construing a statute you have to look at it in context? You have to read the whole lot.

MR GODDARD QC:
Yes, absolutely.

ELIAS CJ:
And try and make sense of it.

MR GODDARD QC:
Yes.

ELIAS CJ:
So it stands out a bit that there are these different approaches taken to establishment fees and prepayment fees.

MR GODDARD QC:
It does, but the reason that it doesn't matter that there's no explicit reference to averaging in section 44 is two-fold in my submission. The first is – well, actually probably three-fold. The first is that you've got this concept of reasonably compensating, and one of the ways you can go about working out reasonable compensation, in my submission, is to say well, what does this activity, this matter cost us overall? Well, if we charge each person –

ELIAS CJ:
But you've got reasonable costs under 42 as well, reasonable costs in connection with those matters.

MR GODDARD QC:

But in 44(1)(a)(i), in relation to the matter giving rise to the fee. So that matter can be administration of loans rather than tied to a partic –

ELIAS CJ:

Well, it's very odd if it is, isn't it, because why wouldn't that be within your establishment costs?

MR GODDARD QC:

Because it's a cost that's incurred over time, not just at the time of establishment. If I have a loan that's outstanding for three years, I'm going to be sent three times as many statements as if I have a loan for one year, and rather than predict at the outset, depending on term, it's perfectly reasonable, in my submission, to charge it for each month while it is still on foot, and it's not a cost, the cost of sending out a statement which bears any relationship to the amount advanced. So it's a flat cost incurred each month and it's perfectly reasonable to say, so we will charge you a flat fee each month that we actually have to send you it. And if that's a reasonable approach to say that the structure, the cost structure is periodic, depending on duration, and completely unrelated to amount advanced, then that makes that sort of fee structure –

ELIAS CJ:

And the averaging, just because it's reasonable.

MR GODDARD QC:

And because there's no other way to do it. You can't sensibly price the cost of sending each statement to each person if you're sending out – if you've got, you know, half a million credit cards that you've issued as a bank at any given time, you're going to work out the cost of sending out half a million statements in terms of the computer facilities you need, the cost of paper, things like that, and do a division. It's almost the only way in high volume transactions that you can work it out. So it will depend on the nature of the business but in many cases –

ELIAS CJ:

And it depends on the nature of the service.

MR GODDARD QC:
It depends on the nature of business. It depends on the nature of the matter and it depends on –

ELIAS CJ:
But simply saying administration without tying it down does seem to be getting away from what is in contemplation, but I understand your argument on that. The other question I have arising out of these provisions that I'd like your comment on is, and it's really what Justice Young was putting to you, but it's the textual indication, I suppose, that is a guide to reasonableness that in 42(b) you're looking to differentiate between the appropriate classes. Is that – I'd just like a comment on that, whether if one was looking for textual indications of what is reasonable, that that is something that should be taken into account, that you can't be flat. If it isn't a flat thing, that it is appropriate to look at relative costs according to the classes of –

MR GODDARD QC:
If different classes cause you significantly different types of cost, it's unlikely to be appropriate to average across all those different classes.

ELIAS CJ:
Yes.

MR GODDARD QC:
And that I think is the message that's being sent. Now that will vary depending on the matter on what you're charging for.

ELIAS CJ:
Yes.

MR GODDARD QC:
There are some activities which you might say well everyone costs us the same and then other activities where, picking up Justice Young's point, how much is at stake will matter.

GLAZEBROOK J:
Where's the textual indication of that in the legislation?

MR GODDARD QC:

The reference to “appropriate class” I think is the indication.

GLAZEBROOK J:

No, no sorry, the more general issue where we had avoidability, now we’ve got ones that can be flat fees and lumped in, where’s your textual indication that that was the view of the legislature? So you’ve said well that’s what you ought to be able to do and that’s what the – because when – well I suppose when it really comes down to it your argument actually is that everything can be put into fees except if it’s the cost of funds plus a margin for the actual lending because –

MR GODDARD QC:

Yeah that’s certainly – yeah.

GLAZEBROOK J:

If you describe the fees appropriately you could lump absolutely everything into fees apart from that and I’m just asking where is the textual indication that that was the sort of thing that they were looking at.

ELIAS CJ:

There's just no constriction of what can be in fees, that’s your submission isn't it?

MR GODDARD QC:

Your Honour is exactly right, it’s more what's not there, that conduct is permitted unless it’s proscribed, that we do see some proscriptions in this legislation obviously and we’re trying to understand their scope.

GLAZEBROOK J:

Well where does the reasonable fee come in then?

MR GODDARD QC:

And that’s the key – the reasonable fee operates as a limit in two ways, first it requires, as I’ve said before, that there be a reasonable relationship between the description of the fee.

GLAZEBROOK J:

Yes but you could – say you can describe any fee you like, then it will always have a reasonable relationship to something on your argument.

MR GODDARD QC:

Yes but if it's obviously interest –

GLAZEBROOK J:

And so unless you get caught out.

MR GODDARD QC:

If it's interest in drag obviously you can't do that and in addition I've accepted, although it's not an issue in this case, that there are some types of fee or descriptions of fee one could imagine which would in and of themselves fail a reasonableness test.

ELIAS CJ:

Because they're not connected with the credit contract?

MR GODDARD QC:

It could be completely arbitrary and unrelated, it could be that it is, I had an example and I've lost it.

ELIAS CJ:

It's still the case though if you go back to the definition of credit fees, it's those payable under the contract to the creditor in respect of, well and the example given or the inclusion given is insurance premiums. So there is still the argument that it is relating to a discrete thing not connected with providing the credit which is the subject of the contract.

MR GODDARD QC:

I don't think that that is an available reading of the definition. Just two things I should draw Your Honour's attention to, again looking back at that definition. The first is that it's under a credit contract or payable by the debtor to or for the benefit of the creditor in connection with the contract.

ELIAS CJ:
In connection with, payable in connection with the credit contract.

MR GODDARD QC:
So it can be in connection with. Yes so it doesn't need to be under and second, the reason for the reference to insurance premiums payable if the creditor requires the debtor to obtain insurance cover from – is that that's an extension of what would otherwise be a credit fee because you are paying an insurance premium to an insurer, not to the creditor, it wouldn't otherwise be within that definition but it's then brought in if you insist on using a particular insurer. So it's not an example of what's gone before, it's a deliberate add-on of something which otherwise wouldn't be included in circumstances where the field of choice is being limited and I don't think it tells us anything more than that is a particular type of charge which has caused concern in the past and that whereas we're not troubled about optional insurance or even about mandatory insurance if you have a choice of provider. At the point where the creditor is saying you must insure and you must insure with this person, that is such an integral part of the cost of credit that it should be subject to the same regulation. So it's dealing with a particular concern or particular abuse and bringing it into a category it otherwise wouldn't form part of.

ELIAS CJ:
Yes I see that.

GLAZEBROOK J:
So what were your two ways it limited or have we done them?

MR GODDARD QC:
The two ways were first –

GLAZEBROOK J:
So a relationship to what you say it is and that there could be some that are totally outside of that.

MR GODDARD QC:
Yes.

GLAZEBROOK J:

Is that the two ways?

MR GODDARD QC:

Those are the two ways in which reasonableness constrains fee charging.

GLAZEBROOK J:

Well then what about level of fee, how is that regulated?

MR GODDARD QC:

That was the first one.

GLAZEBROOK J:

No that was it requires a relationship to what you say it is. So if it has a relationship to what you say it is, could you say a million dollars?

MR GODDARD QC:

Sorry I was obviously using shorthand. What I meant to say was to put it in the way I put it before which is to say that the amount of the fee must bear a reasonable relationship to the matter or service for which you say the fee is charged. So that brings in quantum, that's the most important of that. If I say it's a fee for administration and the amount bears no relationship to the costs to the creditor or the benefits to the debtor of the provision of those administration services, then that's not reasonable. Actually I need to add a proviso.

GLAZEBROOK J:

I don't know that that – that doesn't say anything does it? Because you will have to have a profit margin presumably built into that. One would expect that you would be able to.

MR GODDARD QC:

You may.

GLAZEBROOK J:

It's not a cost recovery measure or do you say it is just a cost recovery measure?

MR GODDARD QC:

It's context specific, so it depends also on the relationship between the fee you are charging and what other people are charging in the market. It depends on the benefit to the creditor of the service.

GLAZEBROOK J:

To the debtor do you mean?

MR GODDARD QC:

To the debtor I mean sorry, yes. So it's all the factors that we would treat as going to the reasonableness of a fee charged in any other context. If one asks whether a fee charged by a professional is reasonable for example, immediately a whole range of factors, including but limited to comparability with fees charged by other similar people come into play. There's no reason to approach this more narrowly. Attention is directed to costs but that's just one part of the puzzle and there's no reason to promote it beyond that in terms of the policy of the legislation and doing so produces unsatisfactory anomalies that are avoidable by a more sensible interpretation. Now let me see what it would be sensible to deal with.

ELIAS CJ:

Well can you give us – because we've taken you all over the place, but I wonder really what is there in your argument that you need to cover?

MR GODDARD QC:

There's not much left and that's what I just wanted to work out. So I think we've covered all the sort of history material except the Australian material and I'm not going to go to that now, I think it's important background and I think it's helpful to look at section 72 of the code and the –

GLAZEBROOK J:

Well where is that so we can check that?

MR GODDARD QC:

In my 3.7 I provide the reference, so it's under tab 2.

GLAZEBROOK J:

Tab 2 of volume 1?

MR GODDARD QC:

Of volume 1. So 3.7 Your Honour of my road map, I've provided the reference to that.

GLAZEBROOK J:

And what page was it on sorry?

MR GODDARD QC:

Especially in section 72 which is on page 68 of the code.

GLAZEBROOK J:

The terminology is different that's all.

MR GODDARD QC:

Yes.

GLAZEBROOK J:

So unconscionable is something quite different from reasonable isn't it or do you say they mean the same thing?

MR GODDARD QC:

It's – I mean Your Honour's absolutely right to say that they are different terms and that they have different resonance legally. It seems to me that unreasonable is a broader term that doesn't narrow the enquiry quite as much as unconscionable. What I rely on, the Australian code and decisions and texts under that 4 in particular, is that they have drawn the distinction that I seek to draw between the limbs of the rule, which contain a definition of what's unconscionable and the limbs which provide for having regard, and they say that where you have regard to costs that doesn't mean it's the only factor and that you can look at other matters.

GLAZEBROOK J:

Well don't they look at the effect on the debtor as well in the Australian cases, which unreasonable doesn't seem to impose does it? Isn't unconscionable just quite a different term with totally different connotations?

MR GODDARD QC:
I think there's overlap. I think it has some different connotations. I think the way it's used in the Australian code brings it closer to our concept of unreasonableness because, as I say, it's defined in relation to prepayments but then used – there's that other structure in relation to establishment fees, for example. But – so that I think is helpful.

And the range of factors that are considered in addressing unconscionability seems to me to be a subset of what you'd look at when you're asking about unreasonableness. In other words, unreasonableness is a broader test than unconscionability and I think that's what Your Honour's really putting to me.

ARNOLD J:
Well, I'm not sure.

GLAZEBROOK J:
Well I'm not actually. I don't think I am putting that to you actually.

ELIAS CJ:
Different standards.

ARNOLD J:
It's a different standard. If you're looking at unconscionability and I think the Australian cases do say that it's important when you're doing that to look at the position of the debtor and the traditional things that you look at in terms of vulnerability, whether when you're doing an unconscionability analysis, and so you can see there that a provision that talks about cost of providing the service is only going to take you part the way because the test of unconscionability is focused on different issues. But unreasonability surely is focusing simply on the reasonableness of the charge and cost is going to be a vital element of that, and the only argument is how broad is the cost base that one considers? And I'm not sure that the Australian cases tell you anything about that.

MR GODDARD QC:
If a charge is unconscionable, it's like to be unreasonable, it seems to me. So anything that sheds light on unconscionability must also be relevant to unreasonableness. But I accept absolutely that there's a wider range of matters that

come into play. That's how it's helpful. When you look at the range of factors taken into account in assessing unconscionability, which include absolute amount, which include comparison with other charges in the market, it's hard to argue that if they shed light on that, they don't shed light on unreasonableness.

ARNOLD J:

Well, I have to say, I'm just not sure that that follows at all because the concept of unconscionability directs you to think about things that have nothing to do with cost and –

MR GODDARD QC:

Except that the only mandatory relevant consideration that's identified in that Act is, of course, cost.

ARNOLD J:

I know, I know but the concept just directs you to go more broadly. So, I'm not sure that it really helps answer our question but, anyway, I understand what you're saying.

MR GODDARD QC:

It's not at the forefront of my argument. It seemed to me it might be helpful, at least to have it available, given that it's explicitly identified as an antecedent in our legislation and extensively referred to in – well, it's referred to in *Hansard* and it's referred to in the policy papers which I'll come back to the relevance of tomorrow.

GLAZEBROOK J:

But they just aren't – I mean they can refer to it all they like but if they aren't following it, then it can't be in the least bit helpful because they're totally misconstruing the tests they've actually put in. So they say, we're doing the Australian thing and they're not at all. Then it can't be very helpful because (1), they've misunderstood the Australian situation, (2), they've misunderstood what they're doing here by their words, which we must construe.

MR GODDARD QC:

Which we must construe. We have to obviously ask what help can be had from it in light of the differences between it. There are differences in language. There are similarities in structure. I think there's some illumination to be had but I don't think it's by any means the most important source of assistance in understanding this. I think

the sort of practicable consideration of, first of all focus on the text and the statutory scheme and Your Honour, the Chief Justice's point, and second thinking through the practical consequences of different readings probably takes us much further than looking at the Australian material.

I've dealt with everything in my section 4 of my roadmap. I've, I think, dealt with the issues in 5 and, in particular, the different categories of cost that one might conclude must be considered and, I think, the way in which those expand outwards from the variable costs of an individual transaction to variable costs of such transactions over some period, be it a year or longer, to avoidable costs in engaging in the activity, to avoidable costs plus an allocation of fixed and common costs, is quite a helpful way of thinking about the choices that are available when we ask, what does it mean to talk about costs incurred in connection with a matter?

I don't think there's anything else in 5 I need to deal with. I've dealt with most of the issues in 6 in passing and in answer to questions. 7, where I bring it back to the facts, I think I have touched on – the 7.1 issues I'm not going to get into the detail. I've touched on a couple of those. The broader factors that are relevant I think I've dealt with in the written submissions and I've touched on – I'll resist the temptation to dive back into training costs under 7.3 and those other categories. What I ha –

GLAZEBROOK J:
Well, I don't know, because securitisation and treasury costs really do look like cost of capital don't they, and I thought you said that if one thing is in interest rates, it's the cost of capital.

MR GODDARD QC:
This is, in my submission, probably the most finally balanced of the categories of cost because on the one had it's a cost of obtaining – well, it's a cost of obtaining funds to lend. Obviously you can't advance the credit if you have no money to advance. So does it come within the concept of establishment fee? It depends how broadly one understands the concept of the cost of advancing the credit.

In terms of the nature of the cost, Your Honour –

GLAZEBROOK J:
It's not really related to, because – oh, well.

MR GODDARD QC:

See, it’s not related to the duration or the quantum borrowing. That’s the thing.

GLAZEBROOK J:

Well, it’s also not related because securitisation usually happens when you grab a whole lot of them together and then securitise later. So it has nothing to do with establishment of particular credit contracts because, in fact, that’s the whole point about securitisation.

MR GODDARD QC:

Usually what you do is you put a securitisation programme in place. So you have arrangements for securitisation and you incur all that in advance and then, having put those arrangements in place, which means that you can gather up a parcel and invoke that arrangement, otherwise you don’t gather up a parcel then go out –

GLAZEBROOK J:

So you’re only looking at the putting it in place, are you, and not the running of the securitisation? I mean you can’t split that up because you will be paying fees as it is securitised and you’re paying fees as it goes along aren’t you, because you’re paying the costs of that.

MR GODDARD QC:

Well, you’re paying people certainly to maintain the programme, and it’s a cost you incur to have access, really, to credit markets. So it’s a fee for – one way to think about it is it’s a cost of having access to credit markets but it’s not a cost of the credit in the sense that it’s proportional to the amount borrowed or the duration of the borrowing.

GLAZEBROOK J:

Actually it is usually proportional to the amount that you're securitising isn't it?

MR GODDARD QC:

Well I think probably –

GLAZEBROOK J:

Well otherwise anybody who sets up a huge securitisation programme is paying exactly the same as someone who sets up a small and I bet they don't.

MR GODDARD QC:

There are significant economies of scale though because you pay –

GLAZEBROOK J:

Well there might be but you still pay an amount that –

MR GODDARD QC:

It's not a strict proportionality. Your Honour is right, I think as a matter of common sense going to be some sort of relationship between scale and costs but it's not a dollar for dollar one like an interest cost. As I said, it seems to me that there is a, you know, that there are arguments both ways on that. What I haven't dealt with, and I've dealt with fixing common costs and the reasonable allocation of those.

ARNOLD J:

Just on that, you talk about a reasonable allocation of those, of course in the competitive market a multiproduct firm will pick those up where it can. I mean it's not where it allocates them, it's the state of the particular markets that it's participating in and in some markets it may not be able to recover fixed and common costs because it's not as efficient a provider or it may be regulated in some situations, something like that. So you recover them where you can. You're right regulators allow them but there's no concept of reasonable allocation in relation to fixed and common costs as I understand it and I remember Professor Bowman said you may as well stare at the entrails of a chicken and try and find the answer there as come up with a reasonable allocation. So how does that concept work?

MR GODDARD QC:

Economists are scathing about the idea. Your Honour is quite right and they tend to talk about Ramsay pricing and loading it into the areas where demand is least elastic because that's where you can best recover it but what we're talking about here is a regulated, by light hand, but nonetheless regulated activity and in my submission it is neither more nor less difficult to come up with a reasonable allocation of costs to a particular matter.

ARNOLD J:

Well it's going to be very difficult to say a particular allocation is unreasonable. I mean the thing about the variable direct costs is you are working something reasonably concrete and you can say well that's in or that's out but when you're talking about a reasonable allocation of fixed and common costs, it seems to me very difficult for anyone to say well that's an unreasonable allocation because what are you working with, what object, standard are you measuring that against?

MR GODDARD QC:

And obviously you've already got the constraint that Your Honour mentioned about is it going to work in the market, you're not going to go beyond that but the point of having this regulation here is that imposes additional standard. The critical issues it seems to me arises for example, like with a firm like MTF from the fact that first of all you have some consumer contract, consumer lending and some non-consumer lending and if you've got proportions of your overall business whether measured by dollar value or by number of contracts and there's room for reasonable difference on that which means in my submission that normally either would be acceptable, you'd be surprised if the allocation of MD costs first of all didn't match to that. So that's the first part and I think you can say putting all of it into one would be unreasonable, it would be surprising. The managing director doesn't just exist for one product rather than for two but then you can reasonably say well what are the demands on the time and energy of the managing director, what do they do and what contributes to this matter or this activity and there will be a range. There will some levels which are patently unreasonable because it's not a realistic reflection of the demands on time but to use some sort of activity-based costing of the kind that all the accountants accepted was a normal tool for management accounting and management decision making, as you'd expect the economists were rude about it, the accountants said we do it all the time and it's useful depending on the purpose for which you're trying to make decision, we do it in different ways, you're in that same space and just as there are rules of thumb are seen as reasonable by regulators, proportionate to time, proportionate to value of business, so too here. If you pick a standard for allocating it which is a reasonable rule of thumb, that will be reasonable but it does set a meaningful constraint, there are things that will be unreasonable.

ARNOLD J:

There's one, sorry I don't want to delay you, but there's just one thing arising out of that that has sort of puzzled me a bit. You refer to the management accountants

agreeing on this and it does seem that your argument is a mix of accountancy concepts and economic concepts. I mean an accountant wouldn't define a cost as including a reasonable rate of return on, you know, the cost of plant and equipment as involving a reasonable rate of return on the capital invested, yet you do.

MR GODDARD QC:

Yes an accountant would treat it as a cost if you borrowed to finance it because you'd see the interest turn up as a cost and so if you lease the equipment the rental would be part of the cost and that would include all of that. If you borrow to fund the purchase of your big computer, that interest cost will be a cost. So even on an accounting approach, depending on how you finance it, there will be a real cost that turns up in your financial statements and an accountant would agree I think, yes your interest bill will go down if you don't borrow to buy these computers. Then you're right Sir that what I say is well it would be odd if you couldn't count that if you fund it from equity rather than debt. So an allowance for the cost of funds is a reasonable factor to take into account. It shouldn't matter whether you're borrowing or using equity.

ARNOLD J:

No but it does to the accountant is my only point.

MR GODDARD QC:

It does and that's – what I'm saying is that there are really whether you approach it from an economic perspective or from an accounting perspective the test below is too narrow and that thinking about it sensibly on either plane takes you to a different line and that ultimately it's not necessary to say it's an economic test or it's an accounting test, what you've got to say is, is the fee reasonable and you can get to a reasonable fee through a range of analytical paths. So that's that one.

What I haven't dealt with is the special issues raised by default fees in any detail and I was going to take the Court to a very interesting decision delivered by the UK Supreme Court last week *ParkingEye Limited v Beavis* [2015] UKSC 67 which is mostly about penalty clauses and contracts but also has a section on application of the unfair contract terms regulations, the European Consumer Protection Rules, including reference to a very interesting case about when default interest payments are reasonable. I don't want to spend a lot of time on that because again it's

something which I think is illuminating because of the range of factors taken into account but not directly comparable to our legislation.

ELIAS CJ:
Do you want to hand it in and we can have a look at it?

MR GODDARD QC:
I was going to suggest exactly that, if Your Honour is happy with that. If I could hand up that through Madam Registrar and I have I think covered most of what I wanted to cover. I wonder if the sensible way to deal with things is to – I'm conscious that I've gone past 4 o'clock. If there are any matters that the Court wants to raise with me tomorrow morning in the light of –

ELIAS CJ:
Well if there's anything that you've overlooked of course you can raise it tomorrow morning.

MR GODDARD QC:
That's really what I was going to seek Your Honour's indulgence to do but it may well be if I find that I've covered everything as usefully as I can and if the Court has no further questions, then I won't need to do anything other than reply after my friend's submissions.

COURT ADJOURNS:4.15 PM

COURT RESUMES ON WEDNESDAY 11 NOVEMBER 2015 AT 10.03 AM

ELIAS CJ:
Sorry I've –

MR GODDARD QC:
No, no Your Honour.

ELIAS CJ:
Well you're haranguing us with articles.

MR GODDARD QC:
I hoped it wasn't haranguing. I was just trying to help and I am not going to spend a lot of time on them but there were just a few loose ends from yesterday that I thought I should deal with and the first of those was the question about reference to materials such as the policy papers which I said I would look at overnight. In my submission the policy proposal papers are helpful but one needs to be clear about the purpose for which they are referred to. For example these papers provide useful background on the relevant sector and perceived problems with the status quo at that time. That's the social context that this Court referred to in *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36, [2007] 3 NZLR 767 as an aid to interpretation and they also provide useful background on options identified for consideration. They're also, in my submission, helpful in relation to the competing policy goals in this field but I absolutely accept that because of the early stage in which they are prepared and the fact that they are prepared by the executive, not in the course of the parliamentary process, considerable caution would be needed in relation to using them to explain the meaning of specific terms or specific provisions.

So what could I find overnight? I couldn't find any authorities expressly on pre-legislative policy consultation documents. There are, though I think there is one reason peculiar to this case for thinking that these are helpful and that is that in the select committee report on the Bill which I have provided, I am grateful to my learned friends for this reference because this is an issue on which there is no difference between the parties, the helpfulness of this material. If the Court looks at the first page of the Committee's report, last paragraph, there's express reference to this consultation process as the genesis of the Bill. So there's an explicit recognition in

the parliamentary process that this was the backdrop to the Bill that was prepared. Outcome of a review undertaken by the Ministry of Consumer Affairs between July '99 and July 2001 based on extensive consultation with the listed groups, six public discussion documents were released by the Ministry and over 100 submissions received. And so there is that linkage and for example in the *Marlborough District Council v Altimarloch Joint Venture Limited and Anor* SC 33/2010 leave decision, in fact –

ELIAS CJ:
We don't encourage reference to leave decisions in this Court, because they are decisions only of three Judges on a preliminary basis.

MR GODDARD QC:
I'm happy not to go there. It's not important. The principle is what matters obviously. So first of all it seems to me that it's helpful in relation to the context against which the Bill was prepared and it's inexplicitly recognised as the foundation for this reform. Second, again dealing with sort of the matter of principle, it seems to me that there's no reason to treat papers of this kind differently from white papers issued by the executive setting out policy proposals on which feedback is sought. These are again executive documents, not parliamentary documents. They're proposals.

ELIAS CJ:
But they're government policy by the time they're in white papers.

MR GODDARD QC:
It's a statement of policy on which – but usually on which further submissions are sought before policy is finalised and a Bill submitted to the parliament. So it's a step closer but it's a difference of degree, not a difference of kind and again that goes to what you can safely use it for and the measure of caution required. It doesn't, in my submission, lead to a bright light distinction, can refer, can't refer. And this is really the thrust of the article. I'm not going to take the Court to it with the wonderful title *The Just Do It Approach to Using Parliamentary History Materials and Statutory Interpretation* by Catherine J Iorns Magallanes and it deals also with pre-parliamentary materials like this, notes that more caution has been shown in relation to their use and makes the point which in my submission is correct, that the real issue is what use can properly be made of the material, what light it does or does not shed on the issues rather than on whether it's in or out in a bright line way.

GLAZEBROOK J:

I would have thought for myself the distinction between just a pure departmental paper and one which is a consultation paper is just that in terms of consultation and the Courts refer to Law Commission material all the time and the Law Commission does exactly that same process. Now one often has to guess whether in fact that's been accepted or not if it's not explicitly noted that it's been accepted after the result of the consultation process but I myself can't see any difference between publicly available consultation document on which consultation has been undertaken, just because it happens to be by a parliamentary – happens to be by a department instead of by some other body. I mean it may be that independence might make it slightly more reliable in terms of the Law Commission but on the other hand it may be that because it's done through the executive and it's the executive's parliamentary Bill, that it might be actually six of one and half a dozen of the other.

MR GODDARD QC:

Your Honour that's in fact almost all of what I was going to say. It seems to me that one might think that a body like the Law Commission was carrying out a more sophisticated fact finding exercise but on the other hand it's less close to the policy process. So there are swings and roundabouts I think and certainly looking back at the law reform committees, again those were committees set up by a Minister to advise the Minister on policy development and, as a matter of principle, it can't matter whether a paper is developed for a minister by a committee, that the Minister is appointed to advise him or her or by the Minister's own officials, as the basis for a consultation exercise and, ultimately, a policy proposal. In either case, in particular, and this is what I think my friend and I both seek to use as material for, it's a helpful snapshot of the world as it existed at the time. It describes the sector, it describes the issues. It's a helpful analysis of the perceived problems with the, then, existing regulatory regime which, of course –

ELIAS CJ:

Well, of course it is, of course it is.

MR GODDARD QC:

It's just that it was suggested by the Court yesterday that it might not be possible to look at it at all.

ELIAS CJ:

Well, we don't normally look at the material because where would it all end.

O'REGAN J:

I think there's definitely a Court of Appeal decision on this because I remember being part of it but we did –

GLAZEBROOK J:

Well, I think that was private – I'm fairly sure –

O'REGAN J:

It was something to do with the Gambling Act 2003, I think, from memory.

MR GODDARD QC:

I wonder if that wasn't Cabinet papers, Your Honour because –

O'REGAN J:

Well, it might've been.

MR GODDARD QC:

– there's plenty of case law saying Cabinet papers are not appropriate because they're not necessarily in the public domain and, again, also to the extent that one attempts to use them to explain them in any particular term, clearly they're too far from the Parliamentary process to do that. So I think that –

GLAZEBROOK J:

It may also be, though, departmental submissions or advice to Select Committees has also been indicated, because it's not public, that it should not be used, I think.

MR GODDARD QC:

Precisely. So the departmental report to a select committee, which traditionally was not a public document, although there's increasing access to them now, but exactly the point Your Honour makes, that there are important reasons of principle in terms of the accessibility of legislation, why one wouldn't look at material that was not routinely systematically in the public domain to interpret legislation.

But going back to the 19th century reports by committees set up to look at issues and advise a minister on the status quo and problem in the private and international law it's space –

ELIAS CJ:

What submission have you not been able to make in this case? I'm really concerned that this is a sideshow, Mr Goddard. What's the submission that you make?

MR GODDARD QC:

The submission is, and I'm going to also come to an indication in the explanatory report on this, that when reference is made to the importance of pricing flexibility, that includes the ability to recover costs through fees, as well as through interest rates and the submission that it was recognised in the lead up to this legislation that there is a legitimate concern about cross-subsidisation by borrowers of larger amounts for longer terms to borrowers, smaller amounts, shorter terms in relation to costs that do not vary essentially with the amount borrowed, and that permitting pricing flexibility to address that would, in principle, be a good thing and that –

O'REGAN J:

Well, can't you just vary the interest rate for a longer term loan?

MR GODDARD QC:

You – in order – if it's really a flat cost you have to have –

O'REGAN J:

Well, what if you don't want to have cross-subsidisation? Why do you have to charge it as a fee?

MR GODDARD QC:

There are two issues with that, Your Honour. One is that you would obviously need to have a lot of graduations of interest rate in order not to achieve that and they would become very subtle as you worked up, query whether, in fact, that's a sensible, practical way to do it.

O'REGAN J:

Well you wouldn't do it unless they were substantial unless they were substantial enough to make it worth doing presumably.

MR GODDARD QC:

But the other is that you get into significant issues in relation to prepayment obviously, because if you calculated it in an interest rate that was designed to recover $200 say, by way of establishment fee from each person over the life of their loan and then they repay after three to six months which is not uncommon, they would not, in fact, out of that have met that cost. So if you're really incurring that cost on entry, at the time of entry, regardless of how long the loan runs and regardless of how much the loan is for, then an efficient pricing structure involves recovering that amount at that time.

ARNOLD J:

But that's all based on cost recovery and your argument is this isn't just about cost recovery, it's also about what your competitors are doing and what the market is doing. So I mean how do we reconcile those two?

MR GODDARD QC:

Well at the least it's about cost recovery and that's common ground. You have to have regard to costs and cost recovery and that legitimately involves the recovery of flat, you know, costs that do not vary at the start by way of a fee and that's seen as positively desirable as efficient.

ARNOLD J:

Well that's the establishment one but not the administration one that just runs through the time you're actually administering the loan.

MR GODDARD QC:

And I must say I slipped into incorrect terminology on that, it's account maintenance fee rather than administration fee, which is probably just worth identifying because it's a little bit more specific I think.

ELIAS CJ:

Account management fee?

MR GODDARD QC:

Account maintenance fee and the idea is that –

ELIAS CJ:
So where do we find the –

MR GODDARD QC:
Yes that was my next thing that I was going to come to. In one second Your Honour, I'll take Your Honour to a contract because that was another question I was asked yesterday that I didn't do and I must do and again if that's a recurrent cost which bears no relationship to the amount borrowed, then in principle it's more efficient to charge it in each month while the loan is still on foot, so that if it's prepaid early it stops and the person is no longer putting you to that expense, you shouldn't be charging them for it and so again in terms of efficient structures which are cost reflective and what in my submission is sought by the legislation, cost reflective but not, you know, cost exclusive pricing that's a sensible approach and that's what's recognised in the policy paper and it's right in my submission as a matter of principle and efficient pricing is not contrary to the interests of consumers. The concern is inefficient pricing that takes advantage of information asymmetries and information deficits but genuinely efficient pricing that targets fees to the events that trigger costs is in principle a good thing because it means the right people are paying for the costs that they generate. I don't think I need to say more about –

ARNOLD J:
Was that the basis on which MTF decided on this policy?

MR GODDARD QC:
Yes and if I give Your Honour the reference, it was to improve transparency and to target the costs to the events that cause them. And Mr Todd discusses this in his evidence in paragraphs 87 to –

GLAZEBROOK J:
What do the Board papers say?

ARNOLD J:
87 and sorry what was the other one?

MR GODDARD QC:
I'll finish answering one question Your Honour then I'll deal with the next one.

ELIAS CJ:
Well I'm actually quite concerned about how much time you're wanting to take this morning Mr Goddard because I thought we were just tidying a few things up so it may be –

MR GODDARD QC:
I thought I was just tidying a few things up but I'm now answering questions from the Court which I can't control. I'll just provide the references that I was going to provide, 87 to 89 which are in volume 3, pages 401 to 402 and Mr Todd was cross-examined on that in the same volume at pages 502 to 503 and he came back to that in his brief at 114 to 116 in relation to paying attention to market factors as well and that's in volume 3 at pages 414 to 415. So I'll just provide those references without going to it, given time.

Let me come next to Your Honour the Chief Justice's question about a contract and can I take the Court to volume 8, page 1411. There are a whole lot of contracts in here but this is as good an example as any. And what the Court will see is lender details, the borrower details, goods and then credit details, initial unpaid balance which was in this case $11,411.48 and how that's made up is set up. Purchase amount, establishment fee, by Sportzone, establishment fee by MTF, security registration fee, the MTF payment protection insurance premium, compulsory insurance of the vehicle with Vero, less a cash deposit. No trade-in amount in this case, so there you get a –

ELIAS CJ:
Sorry I've lost this, whereabouts is it?

MR GODDARD QC:
Credit details, bottom of the left-hand column. So that's all broken out and then payments are dealt with over on the top right, they're monthly, there are 36. The amount of the first payment, the total amount of the payments all set out and then coming down to the interest box, there's an annual interest rate of 14.95% fixed for the whole term and total interest charges over the life of the contract of 2800 and then in the next block down, credit fees.

These are the credit fees that may become payable, $3 a month account maintenance fee charged by MTF and $2 per month account maintenance fee

charged by Sportzone and then over the page, there are only just two more boxes I need to go through. There's the heading at the top of the page, "What could happen if you fail to meet your commitments?" There's a reference to a security interest and then there's reference to default interest charges and default fees and the default interest is explained and then default fees are charged as follows, $50 prepossession fee, $70 repossession fee.

And then the next box full prepayment sets out the basis on which full prepayment is permitted, what the charge will be. There's a formula further on in the contract which is really hideous and there's an administration fee in connection with full prepayment which as contemplated by the Act can be charged if specified in the contract. So that's an example of a contract and then there are a few more pages of standard terms, Your Honour, which I won't go to but that's an example of a typical contract.

Your Honour, the Chief Justice, asked me yesterday if there was any indication in the parliamentary materials that pricing flexibility was connected with charging fees rather than the rate of interest not being regulated and that link is drawn in the explanatory note which is in volume 3 under tab 20 on page 2. The paragraph 4 down that I took the Court to yesterday which talked about the Bill allows lenders to impose any fee provided it's not unreasonable. Unreasonableness in respect of establishment or prepayment fee is defined, a general standard set for other fees. It says, "Thus pricing flexibility is maintained." So that link that by permitting any fees, thus pricing flexibility is maintained is explicitly drawn in the explanatory note.

ELIAS CJ:
Sorry –

MR GODDARD QC:
Sorry fourth paragraph beginning, "The Bill allows lenders to impose any fee."

ELIAS CJ:
Oh you took us to that yesterday.

MR GODDARD QC:
Yes but I didn't appreciate that the answer to Your Honour's question was built into that paragraph where it says, "Thus pricing flexibility is maintained." So the pricing flexibility that's being described is pricing flexibility by the use of fees.

ELIAS CJ:

While scope for creditors to avoid restrictions on interest charges is limited.

MR GODDARD QC:

Exactly.

ELIAS CJ:

So it's the balance?

MR GODDARD QC:

Yes. And I was asked questions about whether MTF sought to recover all its costs and in particular Your Honour Justice Arnold said, "Is there anything apart from the securitisation related costs that wasn't recovered?" And I think I might have said, "No" and if I did I was wrong and that's most readily apparent from helpful summaries in the schedules to the third amended statement of claim which were agreed by the parties and the best place to look at those because the copies in volume 1 are terrible, is a little supplement to the case on appeal that my learned friend has helpfully prepared which actually has legible copies of those pages. That was provided to the Court last week I think.

ELIAS CJ:

What are we referring to sorry?

MR GODDARD QC:

The schedules to the third amended statement of claim. Little slender one with no spine label. So it's skinny and a black spine and unlabelled.

ELIAS CJ:

Oh yes I see.

MR GODDARD QC:

And I am grateful to my friend for providing this. Page 64, it's about the second page in. This is an example. There are others but what the Court will see is that this is the MTF establishment fee, costs actually included and Commission's position on lawful maximum costs and as I say these schedules were agreed by the parties in terms of the accuracy of the information in them and what the Court will see in, there's a block

of MTF calculations and if we look after the descriptions of each row, the fourth row across, what we see is a calculation under MTF's model of $235.06 as the costs recoverable through an establishment fee but the fee actually charged by MTF was $190 and that's as we see in the next column and that compares with the Commission's original view at that stage that an amount of between $6 and $7 was acceptable. That's as the schedule to my submissions shows a position that has evolved significantly over time to now accommodate recovery of between $63 and $88, depending on the year.

Now this varied from year to year. I think in the first year the establishment fee came out at almost exactly $190 but the point I'm making here is that MTF maintained stability of fees, it didn't seek to recover whatever dropped out of its model as the cost.

ARNOLD J:
So it worked out the cost allocation and then made a commercial decision about where it would actual set the level?

MR GODDARD QC:
Exactly and didn't increase it just because the model produced a higher figure than the previous year and that sort of history is the sort of factor that in my submission is relevant to a reasonableness assessment and the paragraphs of Mr Todd's evidence that I mentioned a moment ago, include a discussion of making that judgement. So that was that.

ELIAS CJ:
Is there a schedule relating to the, what did you call it, maintenance of account?

MR GODDARD QC:
Account maintenance fee?

ELIAS CJ:
Yes.

MR GODDARD QC:
Yes all of these are dealt with in here. So you've got 3A, B, C which is the establishment fee for each year. We were looking at the establishment fee for 2007

and then we get into – then there's a whole lot of – the maintenance fee begins on page 80, Your Honour. So for 2006 you see that the cost model produced a figure of $2.72 and MTF charged $3. The next year was a figure of $2.93, $3, next $2.44, $3. So that's what I was referring to when I talked about cost reflective fees but in my submission a measure of rounding, a measure of approximation is also reasonable.

ARNOLD J:

So just while we're on figures, just following up on your avoidable cost argument yesterday, so as I understand it the avoidable cost would be the costs avoided if MTF withdrew from consumer lending entirely.

MR GODDARD QC:

No that wasn't my argument. My argument was the avoidable costs associated with the matter or activity to which the fee relates. So I'm not going for that global approach and I expressed myself too broadly and too generally in my submissions and I've taken us I think down a bit of a, you know, red herring path on that.

ARNOLD J:

Oh okay.

MR GODDARD QC:

So again the question I'm asking is if you take for example processing and considering the application, deciding whether or not to lend and at what rate, you can either do that yourself which is what MTF does or you could contract it out to someone with expertise in making assessments of credit and that's a model which does exist in the market, it's just not MTF's model. So if you're talking about a fee for that limb of establishment costs, then the avoidable costs which are the costs that you would no longer incur as a business if you did not do that and that's –

ARNOLD J:

No I understand that sort of make or buy decision but I thought you were talking about avoidable costs more broadly.

MR GODDARD QC:

No I wasn't and I said rightly that that term wasn't used below but of course there was a strong emphasis on variable costs from some of the Commission's experts and one issue that was canvassed in cross-examination and by witnesses on both

sides was over what timeframe because of course an avoidable cost of an activity is just the same as the long run variable cost of that activity and timeframes were canvassed, including timeframes. So this was an issue below, it was just described in different language. I thought again I was coming up with a helpful label but I caused more confusion than illumination then I regret that but these are variable costs in the long run associated with the activity or matter to which the fee relates.

ARNOLD J:
Right, thank you.

MR GODDARD QC:
And that was squarely an issue below. I think that's most of the loose ends. Let me just check my list. I should also say, by reference to those schedules that I was in a moment ago and the figures that, again just to be clear, MTF is not now arguing that the way it did this as recorded in these schedules is in all respects correct or appropriate but what MTF says is that applying the correct test, the fees charged were nonetheless reasonable, even if costs alone, connected costs are considered and that's partly because in some years there was headroom in some fees, it's partly because, although it included some things that it probably ought not to have included or a higher percentage than it should have included, on a proper approach it could have included other things or a higher percentage of other matters and the High Court accepted that it was open to a creditor to justify a fee by reference to costs that hadn't been considered and there was no appeal from that finding and it's not surprising the MTF process was flawed in some respects given the challenges that the legislation poses in its reading and the absence of any more detailed guidance, either in regulations, although that possibility was contemplated probating some types of fees that didn't happen or from the Commission at that time. So the question in my submission is whether they ended within a reasonable range, even if their process was in some respects imperfect.

ELIAS CJ:
What's the regulation making power under this legislation? Is it pretty broad or is it – does it touch on anything that we've been discussing?

MR GODDARD QC:
I don't think it touches directly on anything we've been discussing. There is the ability I think to prohibit some types – let me just check that before I launch into that

space. That was certainly considered and I'm just trying to remember whether that was where things landed. Oh yes the regulations contemplated prescribing procedures for calculating reasonable estimates of loss arising from prepayment and certain rebates that have to be taken into account in calculating repayments but, yeah it did not in the end I think go beyond that in relation to fees.

ELIAS CJ:
Well what's the regulation making section?

MR GODDARD QC:
The regulation making power is on page 83 of the Act, 138 regulations and the ones that are directly relevant to fees are subsection 1, paragraphs (g) through (h)(a).

ELIAS CJ:
Only about prepayment.

MR GODDARD QC:
Yes that's right Your Honour. Then there were just two matters and I'm just going draw attention to them, not dwell on them, that I hadn't reached at the end of yesterday.

The three, the first was to pick up Your Honour's point that the text obviously is the fundamental reference point for this exercise and that what the test refers to is taking into account costs that are connected with a matter or activity. It doesn't use the word "closely", which was an adverb applied both in the High Court and in the Court of Appeal and in my submission that gloss on the statute is inappropriate. We see it applied item by item, paragraph by paragraph, in the High Court and approved by the Court of Appeal. The question with us is, is this closely connected? In my submission for that reason alone the Courts below applied the wrong test. They should have asked the question posed by the Act in the language of the Act and that would have avoided putting a gloss on it which, in my submission, resulted in certain costs that were connected in the sense that they were incurred for the purpose of carrying out the activity being disregarded. So that's the fundamental point.

Second, the Court of Appeal was wrong to suggest that the other factors going to reasonableness which I identify in paragraph 7.7 of my submissions to this Court, were not supported by evidence and in relation to each of the factors listed in my 7.7

I have footnoted the relevant evidential material that supports the existence of that factor which, in my submission, can be taken into account.

Last one, default fees which, as I noted yesterday, I haven't yet reached. Section 44 identifies two mandatory relevant considerations, not just costs but also reasonable standards of commercial practice and again, of course, both are there to inform the overall reasonableness assessment. Two specific issues which arise in relation to default fees as opposed to other types of fee. The first, which I did touch on very briefly yesterday, is that by definition the cost of bad debts had to be met by people other than those responsible for the bad debt, so when we're asking from whom is it reasonable to recover this and by what means is it reasonable to recover this, we start from the point that the person who causes the cost will not pay for it. And point 1, it's no less reasonable for these costs to be paid by the subset of defaulting customers than by all customers, and I think that's reasonably uncontroversial. So, for example, default interest –

GLAZEBROOK J:

Well, in terms of causes the costs, the company in many instances can cause the cost by lending inappropriately and in some of these very small credit contracts that's exactly what they do. There will be people who default for other reasons but …

MR GODDARD QC:

That's sort of looking back to the root cause and we could look back still further to other social causes of that. The Act has been amended to introduce lender responsibility requirements with effect from June this year which addressed that but again I don't think there's any suggestion that this regime was intended to address in some indirect way that concern. It would be a very clumsy tool to use to achieve it, so it is, as I said, I think, common ground that it's perfectly reasonable for the cost of bad debts to be recovered from customers who default but who do actually end up paying through either default interest, which I think would be the Commission's position, or in my submission default fees, so that takes us back to the question that Your Honour, Justice O'Regan, was exploring with me earlier, why fees rather than interest, and again that is not in my submission the way the Act requires the question to be asked because the question doesn't assume that there's one right answer. The Act proceeds on the basis that there can be a range of reasonable approaches to cost recovery and it doesn't require the most reasonable or the most appropriate to be adopted. What it does is prohibit approaches which are outside the range of

reasonable approaches that reasonable people could adopt. So the right question is, is it unreasonable to recover that cost through a fee rather than through default interest?

GLAZEBROOK J:

So you suggest that anybody who defaults should recover the total cost of the bad debt issues that the company has which could be caused by the company itself and bad lending policies, rather than it being spread in some way more equitably?

MR GODDARD QC:

I'm not quite – what I'm suggesting –

GLAZEBROOK J:

But I thought that's what you said, that the ones who default should pay for the bad debts.

MR GODDARD QC:

So first of all let's take the simple example of a responsible lender and then let's introduce the extra layer of complexity.

GLAZEBROOK J:

It doesn't really – all I'm saying is are you saying that the people who default should pay the total cost of any bad debts that occur in a company?

MR GODDARD QC:

Your Honour is putting to me –

GLAZEBROOK J:

Well I'm not sure what your submission is.

MR GODDARD QC:

No, no I'm about – no I think Your Honour has, with respect, misunderstood precisely what I'm trying to say which is not "should", I'm more much more agnostic than that, what I'm submitting is that what we are interested in is the range of approaches reasonably available. It's not "should", it's "can", "can they reasonably?" So of course it is reasonably open to a lender to recover the cost of bad debts in the interest rate that is paid by everyone by factoring that in.

But it is also reasonably open to a lender to say well hang on that means borrowers who perform, borrowers who pay everything on time are bearing part of the cost of bad debts and that is not either fair to them, to use your Your Honour's conception or efficient in terms of pricing. So what I am going to do, the lender can say, is recover the costs of bad debts from people who default. Now I have another choice to make, do I recover it from the people who default through default interest or through fees or through some mix of those and my submission is that one of the choices that reasonably open to a creditor is to say I will recover some or all of that cost through fees because it is not a cost that is directly related to the amount this particular person has borrowed or to the length of time for which they have borrowed. It's no less reasonable and that's the test, Your Honour. It's not is it the best way to do it because reasonable people can disagree about all of that, the question is it outside the range of reasonable responses and that's all my submission is.

The other point in relation to default fees and this is the purpose for which I provided the Court with the rather lengthy *ParkingEye v Cavendish Square* decision yesterday, is that it is in my submission reasonable for charges with a default interest or default fees to perform an incentive function and to encourage performance and to discourage breach and that is a conclusion that the European Court of Justice reached in the decision discussed in the speech of Neuberger and Lord Sumption, the passage on the unfair terms and consumer contracts regulations that begins on page 44, paragraph 102. So the test there is one of unfairness and the concept of unfairness applied under those regulations which is taken from European law as set out in 103, "The terms are unfair if contrary to the requirement of good faith it causes a significant imbalance in the party's rights and obligations under the contract to the detriment of the consumer."

And a significant imbalance is obviously a factor that goes to reasonableness and what we see in paragraph 106, discussing the judgment of the Court of Justice in *Aziz v Caixa d'Estalvis de Catalunya, Tarragona i Manresa (Catalunyacaixa)* C-415/11, 14 March 2013 is a passage which appears at the top of page 47, there's a quote from the Advocate General's advice to the Court which the Court adopted, as explained in the previous paragraphs, "If default interest is intended merely as flat rate compensation for damage caused by default, a default interest rate will be substantially excessive if it's much higher than the accepted actual damage caused by default." So that's saying if it's just intended to recover costs and you charge

more than your costs, that will be excessive and unfair. Then the Advocate General went on to say, "It's clear, however, that a high default interest rate motivates the debtor not to default on his contractual obligations and to rectify quickly any default which has already occurred. If default interest under national law is intended to encourage observance of the agreement and thus the maintenance of payment behaviour, it should be regarded unfair only if it's much higher than is necessary to achieve that aim." And then the point, very important point in relation to unreasonableness as well, in my submission, finally the Advocate General observes that, "The impact of a term alleged to be unfair must be examined broadly and from both sides." And the same is true of unreasonableness. Provisions favouring the lender may indirectly serve the interest of the borrower also, for example by making loans more readily available.

So that two-sided nature of the concept of reasonableness and the broad range of factors that's relevant are true of both unfairness and unreasonableness and Their Lordships' conclusion, in relation to the overstaying penalty of £85, if you parked your car for longer than the two hours of free parking in this carpark are set out in paragraph 109 and Their Lordships note that the mix of incentives created is beneficial to all concerned, that the amount of the charge wasn't exorbitant in comparison to general level of penalties imposed for parking infractions. Their Lordships looked at what local authorities charged and what other carparks charged for similar parking infractions. Nor is there any reason to think it was higher than necessary to ensure considerate use by motorist to the available space. And then the last four lines after the rhetorical flourish about the risk of having to pay, "It was wholly under the motorist's own control, all that he needed was a watch." Or perhaps one more modern approach might be to say a phone but the next sentence is helpful, "In our opinion a hypothetical reasonable motorist would have agreed to objectively reasonable terms and these terms are objectively reasonable." So there what Their Lordships are saying, in the context of consumer protection legislation is that a term will be objectively reasonable.

ELIAS CJ:

So do they have anything equivalent to section 44 in this legislation that's being construed?

MR GODDARD QC:

No, it's that broad unfairness test, like an unreasonableness test.

ELIAS CJ:
But it’s totally at large is it?

MR GODDARD QC:
Yes.

ELIAS CJ:
And you can only make the submission to us because you say a requirement to have regard allows you to take into account, you know, anything else that’s reasonably connected?

MR GODDARD QC:
It’s really the fundamental point that section 41 poses a test of whether it’s unreasonable.

ELIAS CJ:
Yes.

MR GODDARD QC:
And then you’ve got to have regard provision.

ELIAS CJ:
Yes but you can only make this submission because “have regard” you say is non –

MR GODDARD QC:
Precisely and that’s apparent from the scheme, the text of the statue.

ELIAS CJ:
But what's the point of expressing that in section 44? What's the point of the reference to costs if you're right and that it’s only a fee that’s reasonable in all circumstances?

MR GODDARD QC:
To direct attention to that and to put a burden on the creditor to justify any material gap between their costs and what they charge. So it’s saying you must have regard to costs if your fee does no more than recover, connected, not close, but connected

costs, that very likely to be reasonable unless, and Your Honour made this point, your costs are so absurdly inefficient, gold plated, that they're not. But putting that scenario to one side because there's no suggestion of that here, if you do no more than recover your connected costs on average, then that will be reasonable. If there is a gap, then the creditor will need to explain it and the standard of reasonableness is the right overarching standard to apply in assessing whether the explanation is good enough.

GLAZEBROOK J:

Well – but the way you analyse costs you can, depending upon what you call them in making sure that you call them something that covers your whole business, you can recover your whole business costs. Now you're saying not only can you do that but you can recover more as long as you can say, "Well, my competitors were charging more," or, "I felt like it," or, "That gave me more profit."

MR GODDARD QC:

"I felt like it" is hardly going to be accepted as a reasonable response. "My creditors were charging a lot more and I am far more efficient than all of them," may well be a reasonable response and that comes back to the example given by Justice O'Regan.

O'REGAN J:

This case is about incentives. Are you saying you're allowed to charge more to give people incentive not to default?

MR GODDARD QC:

I'm saying that that can be a factor which is relevant to the reasonableness, yes.

O'REGAN J:

But this case is about whether you charge it or not whereas our case is about how you charge it. No one's suggesting you can't charge for it.

ELIAS CJ:

It's also about whether you charge it.

MR GODDARD QC:

The argument was that £85 was excessive and there was evidence about the proportion of a retired person's pension that made up and things like that. The argument was this is excessive and the Court said –

O'REGAN J:

Yes but this is a price – this is an all-or-nothing. You either pay it or you don't pay it. We're not a price control authority. We're not saying you can't charge these amounts. This case is about how you charge, isn't it? You're completely free to charge as much as you like. It's just you can charge it as interest or as fees.

ELIAS CJ:

I should flag that I'm not convinced of that, that it's not about whether you can charge the amount because I think it still does depend on what the fee is for.

MR GODDARD QC:

Yes. I think His Honour was saying through interest.

ELIAS CJ:

I see, through interest, yes, I see, yes.

MR GODDARD QC:

What His Honour was saying is you can charge what you like through interest subject to the oppression regime, of course, Your Honour.

O'REGAN J:

Correct.

MR GODDARD QC:

So it's not an overall ceiling on price, it's about how it's structured but that question of how you recover those costs is still, by virtue of the legislation, to be determined by applying a test of unreasonableness. Can you say that what was done in terms of the pricing structure was unreasonable and that doesn't mean you have to do what's best and the questions the Court put to me yesterday illustrate that reasonable people can have a range of views about what is a reasonable approach. You don't have to get it right, you just have to be within the range of reasonable responses. I was wrong when I said that there was no more guidance in the European legislation

Your Honour and perhaps just on page 45 I should not that there is an indicative and non-exhaustive list of terms which may be regarded as unfair, similar to the have regard concept to things that focus particular attention, including at 1(e) a term, "Requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation." So that's identified as potentially applicable but nonetheless on these facts not unfair because the incentives it created reflected what the Court describes elsewhere as a legitimate interest in performance and an amount by way of incentive that was not disproportionate or excessive in order to achieve that outcome.

The point that Their Lordships refer to from the European Court judgment about examining these questions, questions of reasonableness from both sides is also one that I think bears –

ELIAS CJ:
Sorry I'm just looking at that provision.

MR GODDARD QC:
I'm sorry Your Honour.

ELIAS CJ:
So that provision establishes unfairness by a test of proportionality which doesn't prevent there being an incentive in the fee, is that the –

MR GODDARD QC:
What I think Their Lordships, that just says that the list identifies certain types of term that may be unfair but it still leaves the question of unfairness to be assessed by reference to that broad standard. So what Their Lordships go on to say is so that may fall within that, it may be one which we're effectively encouraged to have a close look at but the test we have to apply is still the unfairness test and that actually is a similar scheme to what this legislation requires in relation to fees, other than prepayment fees where there's a definition. So again that structural feature from our principle guide on how this is meant to work, the Act, on how fees of the kind is dealt with in sections 42 and 44 are meant to work.

So I think in relation to the range of factors to be taken into account, the need to assess reasonableness, looking at both sides and the long run effects in terms of what it means for availability of contracts of particular kinds, including –

GLAZEBROOK J:

And is there any question that charging fees rather than interest means that there is an availability issue? Obvious there was with parking because if someone’s parked in the spot it will take you time to get them out.

MR GODDARD QC:

Only the general point helpfully explored in the background policy papers that cost reflective pricing is more likely in the long run to enhance the efficient provision of services to those who require them. So lower interest rates for people who don’t default for example will expand availability of credit as compared with higher interest rates because you're recovering bad debts through that. For example Your Honour if I am very sensitive to what I pay on a monthly basis but I know I am a good credit risk, I am going to be in a better position to borrow if the interest rate that I am charged does not include any allowance for defaults by other people. So yes.

GLAZEBROOK J:

Yes I must say I find that unacceptable in terms of I don’t mind the deterrence effect but to load everything onto defaulting debtors through fees or even through interest rates seems to be not exactly what's intended but I mean I find this whole business that you can grab – have all of your costs of business through fees, apart from the cost of funds not actually in accordance with the legislation in any event but we’ve been through that, so there's no point.

MR GODDARD QC:

We have been through that. The point about recovering the cost of default through interest, I would just make the point that clearly that’s not seen as inconsistent with the statutory scheme, the legislation makes specific provision for higher default interest rates.

GLAZEBROOK J:

No, no of course there's – I don’t have a problem with that and the issue of deterrence and the issue of costs that are associated with that, I just have a difficulty with your expansive definition of costs generally and in particular in this area.

MR GODDARD QC:

Well the Courts below explicitly said that it was not reasonable to set default fees by reference to an objective of deterrence and in my submission that's wrong.

GLAZEBROOK J:

I don't necessarily have, I mean I have to look at that but I don't necessarily have a problem with that, it's the more expansive submission that you're making that I have some difficulty with.

MR GODDARD QC:

Of course as soon as you're setting them in part for the purpose of deterrence, that means that they may not be cost reflective because the amount required to operate as –

GLAZEBROOK J:

No I understand that it was the first proposition that you can lump everything onto the defaulting fee and the defaulting debtors I was having some difficulty with.

MR GODDARD QC:

I understand that Your Honour. If the use of a default for –

GLAZEBROOK J:

And it will depend on the interpretation of the legislation whether even the deterrence effect can come in.

MR GODDARD QC:

Of course but if that's legitimate then again the Courts below were wrong to suggest that that couldn't even be taken into account and there would need to be a further enquiry in the context of the default fees into whether they were unreasonable, having regard to that legitimate objective and that is another very important issue on which, in my submission, as a matter of principle the Courts below went wrong and the appeal should be allowed.

I've taken much longer than I expected to. I think I'm about 50% responsible for that but if there's any other questions that I can help with of course I'm happy to do so.

ELIAS CJ:
No that's fine, thank you Mr Goddard.

MR MILLS QC:
Thank you Your Honour. Now what I propose to do, in part because of time but more fundamentally because I'm hoping it will be helpful to the Court, is to first of all give some fairly, I suppose, overview submissions about the way in which the Commission sees the correct interpretation of the Act. Of course, because the Court of Appeal judgment is so reflective of the Commission's submissions to the Court of Appeal, essentially they're there but I think it might be helpful if I just make a few points that have struck me particularly as I have been listened to my learned friend and the exchange with the Court and some key things I think which to me, any rate, say that whatever the correct interpretation of these provisions is, it is not the ones for which my friend is contending.

I am going to do this initial part largely unencumbered by references to background materials or textural provisions. I will take the Court into those subject to timing issues because it does need, in the end, to be anchored very specifically into the text itself, the legislative background and purposes, and the evidence from the trial.

The first point I want to make, then, in that vein is that it is clear that the reason for the CCCFA is that there was perceived to be – and ultimately in the policy paper process that my learned friend has referred to – confirmed to be market failure in the consumer credit market. Now, that might be perfectly obvious from the fact you don't have legislation at all of this kind if you don't have market failure, but there is a lot of discussion about market failure in those policy papers. It's also referred to more safely, perhaps, in the first reading of the Bill but it's clear market failure was the issue that drove this Bill and this Act.

Now, it seems to me that it follows from that that any interpretation of what Parliament was intending by the legislation that relies, effectively, on market self-regulation cannot be the interpretation that the Act intends. Now, putting it as its softest, it seems to me it's a very unlikely view of parliamentary intent.

In my submission, the first of the two favoured interpretations that my learned friend puts forward for how to read these sections that we're dealing with is completely reliant on the market and this is what was referred to in the Court of Appeal

repeatedly, not so much here, as the outlier argument. This is the argument that you determine the question of whether a fee is reasonable by reference to what other creditors in that market are charging. Unless the fee is an outlier in relation to that market, however it's defined and whatever levels are derived from it, then that's essentially the end of the matter and the provisions that we've been looking at most closely, 42 and 44 with their costs references, they really come in as a safe harbour which is how my learned friend referred to it in the Court of Appeal, that it's only if you're an outlier and then you come under scrutiny by the Commissioner or by a debtor as to how that fee was made up. The creditor then turns to the cost fee relationship that the section 42 and section 44 provisions and says, "Well, this is how my cost relate to my fee."

So that, in my submission, is an interpretation of the Act that says, "Despite the fact that we've got market failure here as the whole driver for the legislation, the proper interpretation of these provisions is an interpretation that says the market will essentially self-regulate."

GLAZEBROOK J:
Now, when you say "market failure", how did they define market failure or how do you define market failure?

MR MILLS QC:
Well, let me come forward, then, to my next point which will in part answer that Your Honour.

GLAZEBROOK J:
All right that's fine.

MR MILLS QC:
What I was going to say next is that really to reinforce that first point is that the area of the market that was seen to be producing unacceptable outcomes I suppose in terms of what the desire was about protecting consumers in the credit market, was repeatedly described and referred to in the first reading of the Bill as the most vulnerable section of the market and these were described and examined in some detail in the policy papers and if Your Honours want me to of course I can take you to that but I won't unless that becomes necessary.

This is referred to the Court of Appeal as well, that not only were there concerns about market failure and the equity problems that were thought to be there but there was a particular concern with this most vulnerable group and it was described and, not surprisingly I suppose, as often new immigrants, often Pacific Island, financially relatively illiterate and frequently without access to the principal sources of lending. So they were dealing with the third tier, what's described as the third tier lending market and were perceived to be particularly vulnerable to practices that were not considered to be acceptable. And so when the Act was drafted and the form in which it took and here we're particularly concerned with that aspect of it, the credit fees issues, it's my submission that it needs to be seen and interpreted where there's ambiguity with a clear recognition that what was being aimed at here was first of all consumer protection and then secondly, consumer protection for a particular class of consumers, not to the expense of others but that was very much in focus when the drafting was done and in my submission that has a direct bearing on this question about what's intended by the costs that can be recovered by fees, what's intended by that slipper word "connection" and what was the ultimate outcome that was thought to be desirable here.

Now the next point that I wanted to make on this kind of introductory level is that it's also clear from the background and from the Act itself that it was perceived to be an important step from the old Credit Contracts Act to introduce the Commerce Commission as the regulator. One of the weaknesses that you will see identified in those policy papers was the lack of effective regulation on behalf of consumers under the Credit Contracts Act. It's referred to again, save place for me to refer to it, in the first reading of the Bill but it's very clear that the ability to have the Commission in there as the regulator and effective enforcer of the consumer protection provisions in particular, was seen as a very significant change and one that was overdue.

Now again in thinking about interpretation of these provisions, that seems to me to be relevant because it's only going to be – in order for the Act to be effectively capable of regulation it needs to have a meaning to the extent that it's open which allows lines to be drawn and allows some clarity. To the extent that we're dealing with something, as is suggested, as loose as is this fee reasonable, as I said in the Court of Appeal the suggestion is it be untethered effectively from the costs fees connection which seems to be so clear in the Act, then the Commission is faced with an impractical standard to enforce against. Now if that's the effect of the Act, that's the effect of the Act but in a context where the language we're dealing with not

crystal clear, then again my submission to the Court is that it's important to bear in mind the intent, which I think is apparent from putting the Commission in to this role, that the act be interpreted in a way that enables effective enforcement, where the language lends itself to that.

Now that point goes next, at least in the way I view this, to the second of my learned friend's favoured interpretations of the Act. I think it is clear, partly by the space that it occupies in the written submissions, that the outlier interpretation is the one that is being pressed most hard but the secondary interpretation which gives more recognition to the word "connection" is what has been referred to, not so much here, but in the written submissions and by experts and others, is the so-called beneficial relationship connection and this is the one that I think clearly drove what MTF actually did in the cost allocation to fees and referred to by Justice Glazebrook as MTF's view that they could put every cost of the business into fees except for the cost of capital and that is a correct statement of what MTF did. It's recorded in the Court of Appeal judgment in those terms and that is in fact what happened and if need be certainly I can take you to the evidence on that but I don't think it's been disputed. MTF made an a priori decision that it wished to put all of its costs into fees with that one exception and proceeded as Your Honours know to identify cost centres in the business and then to make these allocations, spreading them across these various cost centres and I will come back to this in a bit more detail because I think it's useful to look at the actual evidence on this but as Your Honours may already be aware from reading some of the materials, there were connections being made, so-called connections, that were so tenuous that the evidence is that really they could've here, they could have gone into this fee pocket, they could've gone into that fee pocket, who knows because the connections were no longer able to be traced in any kind of clear cut way, which comes back in part to the regulatory point, that if that's the interpretation of the Act, that any fee can go into – that any cost can go into any fee, possibly with the exclusion of the cost of capital, although even that became subject to later questioning in the quantum judgment by MTF. Then that is not a standard on which any lines can be drawn. Sorry cost of funds rather than cost of capital is the term I should be using.

ARNOLD J:

I think they excluded securitisation costs as well.

MR MILLS QC:
That's the cost of funds.

ARNOLD J:
That's the cost of funds?

MR MILLS QC:
Yes that's the cost of funds, sorry I slipped in the cost of capital, it's the cost of funds and my learned junior has just corrected me.

WILLIAM YOUNG J:
I thought cost of capital was included.

MR MILLS QC:
It was, in the quantum judgment, it was put forward, yes. So then just combined with that and my learned friend I think mentioned this, this morning, I didn't know that it had come through clearly before but not only was the view that you could put any cost with that exception into a fee, but if you got the wrong pocket for the cost, so you put something into establishment fee which is where most of the costs were put by MTF, and it turned out on under pressure from the Commission or from the Court or wherever, that that really wasn't an establishment cost, it really should have been something else, then you are entitled to reallocate. So that's the argument that's been put forward. It was accepted by the Courts below. So we've got a combination of costs can go into a fee, all of the costs with that exception and then if you get it wrong well you just reallocate it after the event and again, in my submission, that neither of those interpretations, the outlier interpretation nor the beneficial connection interpretation are what the Act intends.

Turning, then, again to some overview points about the critical connection between costs and fees, in my submission it's very clear from the structure of the relevant parts of the Act we're dealing with, sections 41 through 44, the primary focus on costs in determining the reasonableness of fees, leaving aside section 41 just for the moment and just for a moment 43 as well, which I'll have to deal with because of the way in which my learned friend has tried to gain interpretation leverage of that, if I can put it that way, each of sections 42, 44 and 45 all have a primary focus on costs. In 45, which is the third party fee, as between the third party and the creditor passing

on to the debtor, it's the creditor's cost, the cost of the third party. So they're all costs focused.

Now, 43, which is the prepayment fee, my learned friend says look at the way in which that uses the language if and only if. If that's what was meant in the interpretation of the Act, then wouldn't that be what we would find in sections 42 and 44 rather than the mandatory relevant considerations that we've got there.

Now, the first answer to that in my view is that although the section is awkward what it is dealing with is a loss so it's a prepayment by the debtor which imposes effectively a cost on the creditor as a result of that prepayment. Now, what's the cost? What's the loss? Well, the loss as is made clear by the safe harbour provisions that my friend took the Court to yesterday, is the lost interest that would have been paid if the loan had run to term. So it's an absolutely definable figure but not as to the quantum but as to what's in issue here. So it's if and only if it in relation to that particular loss prepayment doesn't run to term the lender has got more money available for lending than it has borrowers and so – or there might be a shift in the interest rate in the meantime and there is a discrete and identifiable loss. That's why that section can be framed in terms of if and only if because that's all it's dealing with and in my submission it doesn't say – it doesn't assist by comparing that language with 42 and 44 to say, well, then in that case costs must have less significance under 42 and 44 than certainly the Courts below have held that it does.

Now, turning back, then, to 42 and 44, just a few comments on that –

ARNOLD J:
Are you going to explain to us at some point, you said that one of the objectives was to address the most vulnerable section of the market? You'll explain to us at some point how your interpretation does address that vulnerable section of the market?

MR MILLS QC:
Yes, I will.

ARNOLD J:
Bearing in mind that somewhere or other the lender must recover its costs.

MR MILLS QC:

Yes they will do that and, of course, the issue here is not whether the outcome of the Parliamentary intent, which is effectively what the Courts have found here in the Courts below, is going to be entirely successful. And, in fact, the most recent amendments which have brought in the consumer lending provisions are a pretty clear indication that Parliament's now decided there was more to be done. So the question of whether there's a policy behind this that makes sense at some conceptual level, or theoretical level, and was the intended policy and whether it really is perfect in its outcomes which it is not going to be in any event because of the clear trade-offs that have made here. That's not the question. So I just foreshadow really what I'm going to say on that, that particular aspect of policy.

So back to 42 and 44, and the first general point I want to make about this scheme is that the submission I made to you comes at this in the opposite direction to which my friend has come at it. My friend begins with section 41. Of course it comes first in the Act, but in my submission that's the come at this question of what's an unreasonable fee from the wrong and literal end. The correct approach under the Act for determining whether a fee is unreasonable begins with establishment fees under section 42, and begins with other credit fees and default fees under section 44. Those are the issues that the Court, and I just note it's pretty obvious but this is not a direction to a minister or anything like that, this is a direction from Parliament to the Courts as to what they must have regard to when they determine the reasonableness or otherwise of a fee.

And, so taking section 42, in my view of this legislation, the Court is directed to begin by asking and answering the questions that section 42 poses, and they are very specific questions. I'll come back later but I just push out a little bit in case I run out of time, that in the course of the cross-examination of Mr Holtham, who was the managing director/CEO of Sportzone, I asked him to look at that section, and taking him through them piece at a time, to ask him whether that was a correct description of the steps involved in establishing a loan. The answer was yes. And so what we see here, and it's reinforced by the section 5 definition that Your Honours were taken to by my friend, is we have a transactional description in effect about what happens when somebody walks through the door of the, in this case Sportzone, and says, "I want to buy a motorcycle on credit." These are the steps involved, they're very discrete, they're comprehensive and what the Court is then directed to have regard to is whether the establishment fee that has been charged for these activities is equal to

or less than the creditor's reasonable costs in connection with those four discrete activities.

Section 42(b), while it does permit averaging of costs, as one would expect, in the way in which the section is structured, and it seems to me simply in principle, before you can average, you must have done a sampling of individual costs, and then from that base, whatever might be a reasonable base to start averaging from, you then do what section 42(b) is talking about and you do your average costs based on the appropriate class of consumer credit contract. So that in my submission is the structure and with the establishment fee that's where it begins when the Court is considering the reasonableness of an establishment fee.

Your Honours will recall that my friend took you to the passage from, I think it was the explanatory note to the Bill, which talked about the language used here being designed to ensure a matching of fees with costs in relation to establishment fees and in my submission that's what the text is saying.

GLAZEBROOK J:
Well is said, "Specific costs," as well actually.

MR MILLS QC:
Yes, and that's what the text is doing. It's telling us specific activities to set up an establishment fee. What are the costs of doing that? Now it's true, that says, "In connection with," and that's, of course, the term that we're confronted with. But that has to be read pretty obviously in the context of that very specific set of directives.

ELIAS CJ:
Well do you say in connection with reads as of or are you saying it means something else?

MR MILLS QC:
No, no, I'm just saying they are the costs that are connected to those specific steps that are identified there and in the section 5 definition for establishing the credit contract.

ELIAS CJ:

Well, but is that - is a synonym for in connection with in that connection of whether the amount of the fee is equal or less than reasonable costs of the application for credit, et cetera.

MR MILLS QC:

Well, the way I read that if I'm –

ELIAS CJ:

Well, I'm just really feeling – you don't need to adopt that. I just want to know what you say it does in connection with, have a – is it anything other than a cause and effect link?

MR MILLS QC:

No, no it's not. No, my reading of that, and it's consistent with the, "Ensure the matching," and so on and also, and I'll come to this, the important role that the establishment fee is seen to have in advancing credit to the debtor is that it is this cost must be connected to these steps that are described here.

ARNOLD J:

Do you support the use of the word closely, closely connected to?

MR MILLS QC:

Well I do, and I don't have any difficulty with – this Court might, but I don't, myself, have any difficulty, nor do I think it's at all heretical for a Court to add a qualifying word when dealing with potentially ambiguous statutory language to make it clearer as to what the statutory intent is, which is what the High Court and Court of Appeal have done here.

One of the cases that's mentioned in passing, in one of the other cases in the bundle is in the context of an Australian decision involving the anti-competitive behaviour where the word was connection, and the Court inserted the word direct in interpreting this. Well, I mean it's a direct connection. So the Court is not, as it said, they're changing the meaning of the statute, it's just the word is making clear what the Court has concluded the statutory, the legislative intent was and here one could find other terms that might be better to capture the concept but what, particularly with the establishment fee, in my submission what is clear here, from both a legislative

history, the ultimate purpose, which I've yet to come to, Your Honour, and that the way in which this is structured because we are talking about what happens, what costs are triggered when this process that's been carefully described here, step by step, takes place.

I was just going to section 4 – does that answer your question Chief Justice? That effectively it's –

ELIAS CJ:
Close connection.

MR MILLS QC:
– close connection and –

ELIAS CJ:
For myself I think it's unfortunate but the Court felt the need to put in another word.

MR MILLS QC:
Yes.

ELIAS CJ:
But I do think that it is capable of not being loose at all in the context that it's used.

MR MILLS QC:
Yes.

ELIAS CJ:
Well, we always say, we often say in connection with something, not meaning vaguely associated with, and in the context of the application for credit processing and considering that application, documenting it.

MR MILLS QC:
Yes.

ELIAS CJ:
I would have thought it is quite a tenable interpretation to say that those are the costs of doing those things.

MR MILLS QC:
Yes, well that's certainly my submission to the Court and I think that's what the Courts below have said. Now I see I'm right on 11.30, so…

ELIAS CJ:
Yes, all right, we'll take the morning adjourned now, thank you.

COURT ADJOURNS: 11.30 AM

COURT RESUMES: 11.49 AM

MR MILLS QC:
Just a couple of points to be picked up I think from just before the adjournment, so I don't overlook them. First of all Justice Arnold's question about the market failure and what particularly was that. I will pick that up further in the policy analysis that I will go over but I think what comes through is a particular concern about comparability. One might think it's the only market failure concern but the issue of the ability to compare, particularly in relation to that vulnerable group that was causing concern, it's the apples for apples issue that's referred to in that judgment of Justice Priestly's in the earlier *Commerce Commission v Bluestone Mortgages NZ Ltd* HC Auckland CIV-2009-409-617, 21 October 2010 litigation. That's certainly part of the identified market failure issues that this legislation was intended to deal with.

The other point I wanted to come back to which I did overlook really when I was dealing with section 43 and the if and only if, is well why not that language with section 42 and 44 which I think I left dangling and there may be other explanations for this but it seems to me one of the obvious ones is that as my learned friend I think explained to the Court what is being done with these fees is that it's always a forward estimate being done. So you're estimating what you think the costs will be in the next financial year or the beginning of that financial year and that's always going to be subject to being off because you're estimating a particular number of loans over which the costs will be spread and so it doesn't lend itself to that decisive language of if and only if for example your cost exceeds the fee or sorry the fee exceeds the cost because there's always a real possibility of that when you're doing forward estimates and it's not intended and you might think that we'd be caught up in the language of 42, it would certainly be a factor relevant under section 41 in determining the final

reasonableness, that the mere fact that you have ended up with a fee that's recovering more than costs as a result of the properly done forward estimates which turned out to be wrong for any one of a number of variety of reasons is one very good reason, it seems to me, why you could not draft section 42 and 44 with that sharp if and only if language that was able to be used with section 43, where you always knew what it was in principle, it the losses sustained from an early payment of a loan.

Coming back then to section 44, which is where I was about to go to before the adjournment. The language of section 44 as I think you noted in particular Chief Justice, is in relation to the matter giving rise to the fee. Now my friend has made – put quite a lot of emphasis in the policy purposes on innovation. The purpose of the Act to encourage innovation and I think Justice O'Regan said, "Well if that was so important why wouldn't it be in the purposes section?" And in my submission that's because it's not a fundamental driver of the Act.

The matter giving rise to the fee in section 42 is of course defined precisely, it's the establishment fee. That's the matter there. The matter there is the establishment fee, it's the cost in relation to that defined matter and the discrete elements in that defined matter. Section 44 is not defining the matter in advanced, as the Court discussed with my friend yesterday. It's leaving open to the creditor to decide what that matter will be but once the matter is identified and the one that's been referred to here is the account maintenance fee, then it's in a sense as defined as section 42 is, with the establishment fee. So if you the creditor say we're going to charge a credit fee under section 44 and that is going to be for account maintenance. Then it is the costs that are connected to that account maintenance fee just as clearly as it is the costs connected with the defined matter in section 42, because there's always going to be an establishment fee, that's why we've got it in 42 but section 44, which in my reading of the background and the legislation, is the response to the innovation point, that we're going to allow flexibility for creditors to have fees, they're not dictated in advance as you can only have fees for the following which as I think my friend said has in some jurisdictions been the approach, you can only have fees for the following five things. Here the innovation is preserved by allowing the creditor to have other fees but that fee has to be defined and once it's defined it is the matter giving rise to those costs and they have to be connected, just as they do in section 42.

ELIAS CJ:
And is that entirely over to the creditor to identify the fee?

MR MILLS QC:
It does seem to be, yes it does seem to be.

ELIAS CJ:
Well I know that that is what the position that the Commission has taken.

MR MILLS QC:
Yes.

ELIAS CJ:
But how does it emerge from the legislation?

MR MILLS QC:
Well simply from the –

ELIAS CJ:
Just the fact that there is no restriction?

MR MILLS QC:
Correct, yes, section 44 – so we've got defined fees, we've got establishment fee, prepayment fees, default fees and then we've got a basket which is generally described as "other credit fees". And so we go back to the definition of a credit fee and at least on my reading of the Act, it leaves it open to the creditor to decide what else they would want to charge as a fee but it's still restricted in the same way as section 42 is, to costs that are connected to that identified and defined fee. So it doesn't allow the big dump of costs that we've seen here under this provision, any more than it does, in my submission, under section 42.

ELIAS CJ:
Well I understand that argument because that's the – I mean one would have thought it was self-evident that it has to be connected once you decide you're going to establish a fee.

MR MILLS QC:
Yes.

ELIAS CJ:
But I'm more interested in the reasonable fee restrictions which, as Mr Goddard, I think rightly accepted, is concerned with the fee itself as well as with the extent of the fee and it's in terms of the – yes, so one would have thought that in assessing the reasonableness of a fee, you look to the indications in the Act as a whole of what is within contemplation and what would be reasonable.

MR MILLS QC:
Well one of the –

ELIAS CJ:
Because at the moment are you saying that any fee which I think the appellant is saying, any fee which relates to the creditor's costs can be charged as a fee?

MR MILLS QC:
No, I'm saying I think two things. First of all any cost that is being recovered through a fee must have the required connection to the fee and it's what is that connection.

ELIAS CJ:
Yes, but what's a fee in the context of the Act?

MR MILLS QC:
I think that's actually defined is it?

ELIAS CJ:
No it's not.

MR MILLS QC:
Well it's something that isn't interest.

WILLIAM YOUNG J:
It's normally a charge for a service.

ELIAS CJ:
Yes.

MR MILLS QC:
It is a charge for a service I suppose. So it's not interest.

ELIAS CJ:
So what's the service?

MR MILLS QC:
Well in this case the account maintenance. MTF's description of it was monitoring the ongoing loan arrangements and one of the issues at trial was what exactly were the steps that were involved in that and was what was actually being charged as that account maintenance fee justified by reference to the costs connection that the Commission was arguing for. And the other thing I was going to say is that of course with section 44, well let me say this first now, section 44 also has the reasonable standards of commercial practice owing to it and it's not entirely clear, not to me at any rate, from the background papers, what role that was playing there and it has been changed. I should just make the Court aware of this, whether you want to actually be taken to it is a matter for the Court but this section has been amended in the 2014 amendments and it's been made clear there in the legislative background to it, that reasonable standards of commercial practice, now at any rate, is not intended to be a standalone test but to simply be an adjunct to the principal tests which is costs fees. But here the reasonable standards of commercial practice certainly I would have thought could have an effect on whether a particular fee which a creditor was wanting to charge was consistent with reasonable standards of commercial practice, not just the amount but the matter for which the fee is being charged. So if we have a fee being charged for the managing director's retirement fund, that might very likely, might come under challenge.

GLAZEBROOK J:
Would that be related to the credit contract though? Doesn't it have to be a fee related to the credit contract?

MR MILLS QC:
Well, let me choose a less extreme example.

GLAZEBROOK J:
I understand that, although that does give a certain limitation on that doesn't it?

MR MILLS QC:
It does, it does. Then the connection thing obviously straight away imposes a limitation, but there is an overarching measure here, which isn't found in section 42, and the recent revisiting of this issue made no suggestion that it was going to be applied to 42. It's limited to 44 only and, again, looking at the structure of section 44, we've got a combination of the nature of the fee that will be being used here is not pre-defined. There's just the right to charge other credit fees, but what you can charge by way of a credit fee is, again, limited, at least as a mandatory relevant consideration to the cost connection, and it's subject also to a measurement against reasonable standards of commercial practice.

And that package might well be seen to make sense, particularly in a context where you don't have a pre-defined credit fee with the discrete steps involved in it that is able to be done with the establishment fee and the default fee and the prepayment fee.

GLAZEBROOK J:
What I was wondering was whether that as specifically in relation to the default fee so that if you are one and a half minutes late in handing in your cheque, should you impose a default fee, and reasonable standards of commercial behaviour would say no you don't?

MR MILLS QC:
I'm sure that's right, Your Honour, but I don't see why it should be limited to that.

GLAZEBROOK J:
No, no, I just wonder whether that was one of the reasons why –

MR MILLS QC:
Well, it could be.

GLAZEBROOK J:
– that was in there, that it was effectively another break, not a widening, as has been suggested, but actually a break.

MR MILLS QC:

Yes, well, I would have seen it as a break. I would have thought it's an overall cap really in light of the more open textured nature of this section and, as I said, in the 2014 amendments, which are in the appellants' bundle of authorities, it's made clear that it's not a stand-alone test. It's a supplementary test to the fundamental test here which, again, is this cost fees connection.

ARNOLD J:

44(1)(a)(i) just talks about any cost, not any reasonable cost, which is the language of 42, and I wonder if (b), reasonable standards of the commercial practice is getting at the idea that there may be instances where a particular creditor has, for example, on a default, a very elaborate, overblown and costly default procedure –

MR MILLS QC:

Remedial process.

ARNOLD J:

– that they use instead of a much simpler, more direct and less expensive one, and all that is saying is that, in addition to the point that you made in response to Justice Glazebrook's example, it maybe just providing a mechanism to say, well, that is your actual cost but, in fact, we're not going to allow it because you're adopting this sort of weird, expensive procedure in the face of these alternatives which are more efficient and cheaper and what most other people in the industry do.

MR MILLS QC:

Yes, well I think all of those things appear to be open. They haven't been tested, of course, but I think they appear to be open and it is interesting again trying to assist the Court with reaching the conclusions that you're going to have to reach about what is intended by these provisions.

Again my friend took you to it but the language from the explanatory note, I think it was, about section 42 being intended to ensure, section 44 being intended to encourage the connection between cost and fees. And what does one make of that? All I can make of it is that it's consistent with this slightly more generous language under section 44 than under section 42 and 43. For example, we've got section 44 talking about "reasonably compensates".

Now one of the possible explanations for that is, and one does wonder who drafts these things sometimes, but section 44 has very inconveniently tried to compress for economy but not for clarity into a single section both questions of costs incurred and losses incurred. And so we've got, what seems to have happened is the language of compensation, which one would normally associate with a loss, has been used as the single term to cover both the limb dealing with costs and the limb dealing losses. So it's not terrific drafting and the amendments have now split these two apart and given clarity to it by dealing with costs in part and losses in the other.

So I don't think, in the end, I have not been able to give any more significance to the use of the word compensates than that. But it is, the Court will have seen, it is different language to the language of section 42 which talks about reasonable costs and not reasonable compensation. But it just seems to be part of the slightly unsatisfactory drafting of some of these provisions.

The next point I wanted to deal with is this question of just what is the status of these mandatory factors. Both parties have agreed that the must have regard to gives rise to mandatory factors that the Court must consider but what is their status here? And it's in this context that my learned friend has taken the Court to *Sandford Ltd v New Zealand Recreational Fishing Council Inc*, which I know some members of this Court were members of the Court of Appeal at the time that decision was given. Just for reference, if you want to look at it again, it's in the bundle, let me see her, it will be in volume 2 of my friend's bundle at tab 11, and I just want to spend a moment on this because of the way in which it's been suggested it has a bearing on the reading of these provisions in the CCCFA. So it's at tab of 11, and three of Your Honours were the Court in that case.

Now as I understand it, just while Justice Arnold's still trying to find it, I'll just make some general comments about the way I think my friend is suggesting this has a bearing on the case before this Court. You'll recall that there, there were two different parts of this –

ELIAS CJ:

Didn't this come on appeal to the Supreme Court, this case? There was one about recreational fishing in Kahawai but presumably not on this point.

MR MILLS QC:
Not to my knowledge.

O'REGAN J:
There's quite a lot of fishing cases.

ELIAS CJ:
Yes, there are a lot of fishing cases.

MR MILLS QC:
It did, but not affecting this point I'm being told.

ELIAS CJ:
Okay, thank you.

MR MILLS QC:
So as I understand the point that's being made here, it is that in the *Sanford* decision, the Court was confronted with two different terms. One was, "Have regard," which is what we've got here. The one was, "Have particular regard," and the question was, what difference did that make? And in the context of dealing with that, there's some interesting discussion about how one treats the language "have regard" and my friend, I think, is deriving from that, that it's really, it's a relatively, well, take a look, think about it but it doesn't have any overwhelmingly – any overwhelming weight in the way in which the analysis proceeds. And I'm just looking for the best capturing of that. 93 and 94 my friend is telling me.

Yes, but 92 captures the actual issue, "The Minister must have particular regard to sections 7 and 8 but is only required to have regard to section 7 and 8 of… So one in relation to the total allowable catch, that was have regard, but in relation to the total allowable commercial catch, it was particular regard, and that's picked up and discussed on the next page at 94. We think the requirement to have regard to a matter is readily understood. What is required is that the matter is considered but not that it necessarily influences the decision.

And then further down at 96 the requirement to have particular regard is more problematic and in that case and one of the points I want to make about the context here, the reference to "Have particular regard" was to have – related to a long list of

issues and not surprisingly the long list of matters of relevance which were quite general and you'll see that point being made at paragraphs 98 and 99, that although the Court concluded that particular regard would be likely to be seen as a direction to have a greater obligation on the decision maker than the requirement to have regard to a consideration and that one must have been intended to more onerous than the other, where the requirement is to have, this is 99, "Where the requirement is to have particular regard to a specific factor of obvious relevance, the Wheeler test is appropriate." In other words higher test, "but where the decision maker is required to have particular regard to a number of factors of varying relevance which are expressed as general purposes rather than specific criteria, the decision maker must be permitted to discount those which are not relevant" and so on.

So here as I read the judgment, the language "particular regard" and anything it may otherwise have conveyed founded on the generality of the matters to which the Court was being directed to have particular regard. Now what is significant about that case in my submission, when contrasted with the language of "have regard" in sections 42 and 44, is that unlike the position there, two things, first of all it's a direction to the Court and not to a Minister, it's not administrative law case, this is statutory interpretation of a direction to the Court as to go about determining the reasonableness of a fee but secondly, the matters that the Court is directed to have regard to are highly specific. So the weight of the "have regard" here in my submission is carried not by the language alone but by the very specific matters to which the Court's attention is directed and it clearly would have been very odd drafting to have then said, take 44 for example, the Court is to have particular regard to the following. The particularity of the regard is identified by the particularity of the matters to which regard is to be had in my submission. So all I say about it is that *Sandford*, without questioning it at all needs to be treated carefully when applied to this statutory interpretation and in my submission the weight that my friend seeks to put on it is not appropriate in relation to these specific provisions. The Court must reach a view on the relationship of fee and cost before advancing to section 41 on my interpretation of the Act.

Now related to that and this is self-evident I guess, that unless a requirement to consider the relationship between costs and fees charged is to be read out of existence, which is in my submission is what the outlier interpretation effectively does, then the need to draw the line and decide what is a connection within the meaning of the Act doesn't change by putting the line in a different place. There's a

line here created by these sections and by the language connection which is to be drawn, unless it's just read effectively out of existence and I did note with some interest a passage in my learned friend's submissions which if the Court wants to note it it's at paragraph 6.21. I may not need you to go to it but I just mention it. The point that I understand my friend is making there, he's looking at the various scenarios that he set up and he's looking at his scenario A and I'll just get that submission handed to me in case I need it, but the comment that's made in relation to this is yet another example of the perverse outcomes of the interpretation given by the Courts below, is that any cost based approach produces a perverse outcome in that context. So that doesn't go away by drawing the line somewhere else. It is the Act, unless one concludes that the Act isn't putting that weight on the connection between costs and fees which in my submission is not an open interpretation of the Act, the question is just where's the line and that turns on the connection issue and on the purposes for which all this is being done which I will come to momentarily. Any cost based approach requires lines.

ELIAS CJ:
Well sorry where is the line? The line must simply be if it's reasonable, isn't it, the fee?

MR MILLS QC:
No in my submission, Your Honour no, because that's my friend's position that that's the test. The view that I'm putting to the Court which is the view that was upheld in the lower Courts is that the section 41 reasonableness is a final question that the Court comes to after it has engaged in the analysis of these mandatory requirements imposed. The role of the section 41 provision is in my submission a narrow one, which is what the Court of Appeal said, that it is not intended to lead to an enquiry which is totally different from this cost fee focus which is so carefully crafted in sections 42 and 44 and which the legislative history confirms as being deliberate.

ELIAS CJ:
Look I understand –

MR MILLS QC:
Did I misunderstand?

ELIAS CJ:
No, no I understand that framework that you are arguing that the cost connection is what drives the whole thing but the line, if you're talking about a line, the line can only be the statutory line drawn which is reasonableness which I think is an objective standard. I don't much go on Mr Goddard's reasonably open approach here because ultimately the Court has to decide if it's reasonable.

MR MILLS QC:
Yes. Well in my submission, Your Honour, and this is the view certainly taken in the Court of Appeal in particular, the question of what is being addressed under section 41 and this final question under 41(1) of whether the contract is providing for a credit fee or a default fee that is unreasonable, comes to that point after the determination of the fee cost relationship and if the fee doesn't exceed the reasonable costs, then it's going to be reasonable. It's if it does exceed it, that there's going to be an issue that arises under section 41. The question then is what are the matters that can be raised under section 41 that are relevant to displacing the –

ELIAS CJ:
Sorry just a moment, why would you say that, if the fee doesn't exceed reasonable costs it will clearly be reasonable? I thought we just discussed that the reference to reasonable standards of commercial practice might enable you to say that a fee that didn't exceed reasonable costs was still not reasonable.

MR MILLS QC:
Yes, I needed to distinguish, and I didn't do it, between 42 and 44 because they do operate differently.

ELIAS CJ:
Oh I'm sorry right.

MR MILLS QC:
I was really kind of looking at 42 but I should have made that clear but it applies equally to 44, although there, as we've seen the text is not as tight and as prescriptive as 42 is but in either case, in my submission, the framework of relevance under section 41 is shaped by this very clear focus on fees as a means of recovering the cost of performing the activity to which the fee relates, so that when you come to section 41 and this is certainly how it's treated in the Court of Appeal, what's relevant

is not an open field. It is matters that are relevant to displacing the consequence that flows from the mandatory factor applications and in the Court of Appeal, the view that was taken raised an issue of onus and the *Ithaca (Custodians) Ltd v Perry Corp* [2004] 1 NZLR 731 (CA) which my friend I think gave a tick to in his oral submissions, so the approach the Court of Appeal took was and I have to say on the urging of counsel for the Commission, was that the factors that would arise under section 41 to displace the conclusion under 42 or 44, that the costs exceeded or the fee exceeded the reasonable costs, would be a matter on the facts which it would be open to the creditor to raise but because the matters relevant to that would almost certainly be within the knowledge of the creditor and not the debtor, there'd be an evidentiary onus on the creditor as in *Ithaca* as the party with the knowledge to come forward with the identified factors that led a creditor on the specific facts of a particular case to say well yes it did but it's not unreasonable because and one of the most obvious explanations is because these number of credit loans changed, the divisor changed and on our forward estimates we've ended up with a fee that exceeds our costs because of that which is one of the reasons, as I said before that you can't use the if and only if language because these are all concerned forward estimates over a 12 month period at least. So that's how certainly my –

ARNOLD J:

So that is what the Court of Appeal is talking about at paragraph 58 of its judgment because I found it a bit – I was a bit puzzled by what the Court said at 57 and 58, but is that the – because they seem to accept in 57 that it's open to a creditor to raise these additional factors but then they say however there's little scope for holding reasonable under 41 an establishment fee that exceeds. So I want entirely clear of what was being said.

MR MILLS QC:

I'll just find that Your Honour. Yes that's certainly how I had understood it, that the – perhaps because I knew what the submission had been but that the – it's open, this is paragraph 57, "It's open to the creditor to put forward in issue some particular factor which might impact in the specific circumstances of that case on what is reasonable. This opportunity arises as part of the prescription in section 41 that a consumer credit contract must not provide for a credit fee or default fee that is unreasonable."

ELIAS CJ:
Sorry what paragraph.

MR MILLS QC:
57 Your Honour. It's 280 of volume 2. Then 58, "However we consider there is little scope for holding reasonable under section 41 an establishment fee" and they're talking about establishment fee here, "that exceeds the creditor's average reasonable costs in relation to the format as identified in section 42(a). Section 41 is silent on the question of onus of proof" and then they go on to talk about that and refer elsewhere in a footnote to *Ithaca*.

ARNOLD J:
Well what I was puzzled by is that first sentence in 58. I just couldn't quite see how it meshed with what was said in 57.

MR MILLS QC:
Well I think – my reading of it in any rate, is that it's a reflection of this view that the main test is derived from sections 42 and 44, the mandatory relevant considerations. Section 41, as I submitted at the outset, comes after that in terms of the enquiry. So you've got a fee where the fee exceeds the costs and the question then is it nonetheless reasonable and in raising the issue of whether it is nonetheless reasonable, onus on the creditor because it will mostly relate to their internal workings, not always but significantly, to say well why it is and it's a perfectly good explanation and it's reasonable in the circumstances but the Court of Appeal is saying that, and it may have been reflecting in part the facts here where the Court had already concluded that MTF had come at the whole analysis in a way that bore no relationship to the Court's view about what the Act required, just everything in, just find a pocket for it but the Court of Appeal's view was that because those two sections, 42 and 44, are confining the enquiry, section 41 is not an invitation to disconnect from the cost fee analysis. It is intended to enquire into the cost fee analysis and how despite the fact that has not complied with that test under the two sections we are looking at, nonetheless on the facts of the particular case, it's not unreasonable for that fee to have been charged. Have I answered it?

ARNOLD J:
Yes I do understand that. I mean I still do find it slightly puzzling because there does seem to be an acknowledgement I think in your submissions that other factors might

be relevant but it's very hard to put your finger on what they might be other than the one that the example you gave where you actual costs turn out to be different from the estimate and somehow that can justify it.

GLAZEBROOK J:

Can I just ask you whether you – one of Mr Goddard's major examples he gives is somebody becoming more efficient because they've incurred major capital expenditure, whether you would see section 41 as enabling them to say in that particular circumstance, I think myself it's a straw man but whether it would enable to say in that particular circumstance well we have actually had a major reduction in costs but it's because we've changed our business structure and we need to be able to recover some of the costs of that capital expenditure.

MR MILLS QC:

Yes or alternatively it's altered the cost fee structure during the course of the year just by dropping the costs but the fee stays the same, you know, which is another aspect of that question. Yes I mean it seems to me that section 41 is not seeking to anticipate in any specific way what might be raised by a creditor saying, "My fee is not unreasonable" but what the legislation does do is to direct that it's not an untethered enquiry from the very specific cost fee focus that is dictated by 42 and 44 and that does flow through in my submission to the overall policy question which is what's going on here really and I think it's clear that what was intended here is that there would be restrictions on what could be recovered through fees so that competition would take place more clearly through the interest rate which leant itself to comparability more readily than what we've got with an unrestrained ability to put all costs into fees or none or whatever. Now as I said before in an exchange with Justice Arnold, whether that statutory purpose will be or has been successfully achieved by what the Commission contends is the proper interpretation of the Act is another question but is there a rational policy and is that apparent from the background material and the drafting of the legislation as a purpose, in my submission yes and I will come to that by specific reference to some evidence from Dr John Small, one the economists who was called, talking about the consumer advantages of trying to push the pricing into the headline interest rate particularly for this vulnerable, relatively financially illiterate group with which the legislature was particularly concerned. So there's a rational policy behind, restrict what can be recovered by fees and push more into interest rates. My friend has correctly said that in the course of the policy discussion, policy papers, that the idea or the

possibility of banning all fees was considered and you will see in those policy papers that it was recognised that if that was done then that would certainly enhance comparability, apples for apples comparability based on the interest line.

That was not followed but it does not follow from that not being accepted that there was an abandonment of any constraints upon what costs could go into fees and the constraints that were left are the ones we are looking at right now which is there had to be a connection between a cost and a fee before it could be charged as a fee, otherwise into the interest rate and again in the 2014 amendment process, that view is expressed specifically in some of the background documents in our supplementary bundle that the intention always was to have competition principally on the interest rate.

ELIAS CJ:
But why – sorry I just didn't take a note of quite how you put it, but why is your emphasis on the relationship between the fee and I understand the importance of cost but why isn't the question under section 44 for example, the matter giving rise to the fee? Why isn't that the focus?

MR MILLS QC:
It's the focus once the matter is defined as a specific fee.

ELIAS CJ:
But fees are for something.

MR MILLS QC:
Yes.

ELIAS CJ:
What is the matter giving rise – what can be a matter giving rise to a fee? Is there no constraint on that?

MR MILLS QC:
Well this is I think back to the discussion we might've had previously which is, at least as I read that provision, the establishment fee is a matter, it is an activity that gives rise to a fee and a cost associated with performing that activity. Section 44, because it's other credit fees without the particular fee being defined in advance. Once we've

defined the fee, once the creditor has, here the account maintenance fee, then the matters giving rise to that fee are the costs connected to it. So what's involved in doing account maintenance?

ELIAS CJ:

Well the matter giving rise to the fee must be account maintenance, it’s not the fee.

MR MILLS QC:

Yes. No, so it’s the activity involved is the account maintenance.

ELIAS CJ:

But it has to be account maintenance relating to the credit contract.

MR MILLS QC:

Yes it does, as it was here. There's no dispute here that the account maintenance fee that MTF use did relate to these credit fees that we’re dealing with. The only difference as I see it between 44 and 42, other than the issues we’ve been talking about, about commercial practice and so on –

ELIAS CJ:

What is account maintenance sorry? It’s just all these words really which are not in the legislation.

MR MILLS QC:

You need to be a third tier borrower more frequently Your Honour.

WILLIAM YOUNG J:

Well presumably it’s for sending out the statements, making sure payments are made.

MR MILLS QC:

That sort of thing. Checking on the fact that things were moving along and keeping in touch with creditors or debtors rather in certain circumstances or -

WILLIAM YOUNG J:

That’s presumably basically done by computer programme I assume.

MR MILLS QC:

Well it depended who it was. I mean with I think Mr Holtham's evidence for Sportzone which was a relatively small Christchurch motorcycle seller was that there was a pretty personal relationship and some of that was being treated as account maintenance. Keeping in touch, is everything okay, so on and so forth but certainly with a more highly automated process at the MTF end, then yes my memory of the trial evidence was that they were indicia, in effect that would pop up that says it's not in default but there's some issues here that require some attention and they were under the account maintenance fee. So the –

ELIAS CJ:

But it can't be just whatever the creditor wants to spend its money on. It's got to be something that's provided to the debtor.

MR MILLS QC:

Yes it does, yes it does.

ELIAS CJ:

So I can see that sending out statements that the debtor needs is one thing but how do you – what do you say the controls are on the identification of fees?

MR MILLS QC:

Well, I say that my reading of the section is that under section 44 is to define the activity for which the fee is being charged. That's the matter giving rise to the fee and as I say the easy analogy to see that is section 42. The matter giving rise to the establishment fee is the four activities that are defined in both the definition of the establishment fee in section 5 and in section 42. So we come to section 44. Credit assessor wants to charge a credit fee. So what's the activity in relation to that loan for which we're intending to charge this fee?

GLAZEBROOK J:

And you have to first of all have that activity, presumably, so that you can't just say, "I'm going to charge a fee for administration," and not do any administration.

MR MILLS QC:

No, because then you won't be able to show a cost, apart from anything else, that was connected to that fee and justify it. But that's the first step, identify the activity,

want to put a fee on it rather than charging it in the interest margin, we want to charge a fee for it. So what's that fee? Well, here MTF says, "Well, our activity is account maintenance. Here's what it is," and that came under close scrutiny at trial as to what were they actually doing and what was actually the cost of that and that's the inquiry, and then you apply to the mandatory relevant factors to ask yourself does it comply with section 44?

O'REGAN J:
But it also has to be a credit fee as defined, doesn't it?

MR MILLS QC:
Yes, it does.

O'REGAN J:
So it has to be something for the benefit of the creditor in connection with the credit contract.

MR MILLS QC:
Correct, Your Honour, yes, and the dispute over account maintenance in this case has not been over those issues, although from the point of view of understanding and interpreting the Act that is how it would work. The real issue with the account maintenance fee here was that the evidence was that the account maintenance fee was used, really, as the reserve position where MTF couldn't find even on its incredibly broad view of connection, couldn't really find a connection with establishment or default and so it went into account maintenance and so that was really the principal issue at trial with the account maintenance fee that these were not costs in connection with and these were not costs that could justify the activity for which that fee was being charged.

So this is back to this core issue here about what is the connection and the view from the appellants that it is either the outlier or the beneficial relationship test and the view from the Courts below and the Commission is that what's been characterised as close connection.

Just in that context, I wanted, because of a question you asked me, Chief Justice, that it was unfortunate that the word "close" was put in, I thought I should just draw Your Honour's attention to – it's in volume 2 in the case on appeal to the way it was

actually expressed in the High Court. It's at page 205 of the volume 2 of the case on appeal. You'll see at paragraph 66 the more nuanced way in which Justice Toogood expressed this. He said, "After looking at a number of cases, all of which are in the case bundles here but haven't been referred to, the deal with this word 'connection' all depends on context. It can be wide. It can be narrow." He referred to *Yurjevich v Commissioner of Inland Revenue* (1991) 13 NZTC 8, 185. Bearing in mind the statutory purposes identified and the focus of the statutory wording upon particular transactions is appropriate to adopt the test from *Yurjevich*.

"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." And that just became a shorthand subsequently and in the Court of Appeal as the close connection test but it's very much derived from context and neither my friend or I so far have drawn Your Honour's attention to the language in which sections 42 and 44 express because I think it's so clear from the judgments but argument that was made or the issue that was raised about these sections is that when you look at them they use the definite language. So taking 42 for example, 42A, "Whether it's equal or less than the creditor's reasonable costs in connection with the application for credit, processing that application." So this was the argument that the initial focus before you average is on a specific transaction and trying to analyse the creditor's costs in relation to a specific transaction, that's what Parliament intended and then from that you can average but you'll see that referred to repeatedly in both of the Courts below which is why I hadn't dwelled on it particularly but it's an important part of the textual analysis in my submission.

GLAZEBROOK J:

Can I just – just this whole onus of proof, obviously there seems to have bee – the Court of Appeal had that split onus on the basis that it would be the financier who would actually know about these things but that must be the case in terms of cost as well.

MR MILLS QC:

Mmm.

GLAZEBROOK J:

So presumably there's at least an evidentiary onus so that if you have an outlier fee and some sort of evidential basis for saying this might be unreasonable, then I would have thought at least the evidentiary onus would shift onto the financier to say well these are my costs and so I'm not quite sure why the – you might be talking about onus of proof shifting later but it's a slightly odd situation because really it's one of those things where the financier knows their costs, nobody else does, least of all the Dispute Tribunal and least of all the person, not the Commerce Commission who could still challenge this.

MR MILLS QC:

Yes theoretically the individually debtor could but of course in practice –

GLAZEBROOK J:

Yes in practice it's unlikely.

MR MILLS QC:

- what's happening is the debtor goes to the Commission and the Commission then exercises its wide powers to require information just as it did here and to interview people and so on and the Commission will, as a result of getting material from the creditor, will form a view, an initial view at any rate, on whether there does seem to be an issue around the cost fee relationship and also whether the estimates have been thrown out by the divisor and so on. I think the reason for the emphasis on the section 41 issues in relation to an onus question was because as 42 and 44 are asking questions which are predefined, in effect a cost fee relationship, when you come to section 41, at least on the way in which the Courts below have interpreted its function, you have something more than that. You have got discrete matters which aren't just related to a cost fee issue which only the creditor may know about. So for example here a creditor saying well we were thrown off by the Commission's guidelines and that affected the way in which we went about this and that's a reason why, in this particular case, our fees shouldn't be treated as unreasonable. Now the response to that at trial after examining the evidence, was to reject that on the basis that there had been a very deliberate and very aggressive approach to allocating all costs to fees, despite some internal emails and so on showing dissenting voices on some of this within MTF. But I think there is a difference, I'm not saying Your Honour that there might not be an evidentiary onus issue which could also arise in relation to 42 and 44, *Ithaca* I think would give support for that as the party who has got the

knowledge but it comes up in a different form I think potentially under 41 because it is potentially raising discrete matters which a creditor wants to put in issue to say despite the cost fee issue being out of whack, we still say it's not unreasonable on these facts. That at least is the structure that I think has been put on this by the Courts.

Now just on the MTF costs approach, I thought for a while that there was a bit of dispute about what had happened here but it seemed to me from some of the questions from Your Honours that there's misunderstanding on your part but just to make this clear, that it is correct that essentially MTF said we are intending to put all of our costs of the business into fees other than the cost of funds, this is from the Court of Appeal judgement at paragraph 21, cost of funds, cost of securitisation and cost of capital. That's what the Court of Appeal recorded that that was the position. Mr Todd described that as all of the operating costs of the business going into fees and you'll find that in the case on appeal at page 401, if you want to check that reference. And so that's what was done here.

I wasn't counsel in the quantum hearing and my learned junior Mr Francis did that but as I understand it at the quantum hearing MTF sought to reopen those issues and sought to argue that those costs could also be included in their fees and of course you've heard and had the exchange with my learned friend about his position that you can put in any cost unless it's wholly unrelated to the fee, in other words the connection test is to ask is it wholly unrelated, if it's not it's connected within the meaning of the two sections we're looking at. A view which is of course strongly disputed by both the Courts below and by the Commission.

Now this has probably been sufficiently dealt with by now but in case it has, let me briefly touch again on this I think quite strong criticism from my friend that this interpretation that at least comes before this Court does not represent a coherent policy, can't be right and again it is this way in which the Act deals separately with fees and interest, an issue that's been the subject of several exchanges and I think probably now is clear to all of Your Honours, that there are – it is quite clear there are restrictions placed on the use of fees and I think Justice O'Regan commented at one stage, if we look at section 3 of the purposes provisions, that it says specifically in 3C that one of the purposes of the Act is to provide rules about fees. Now rules imply something that you can say, right this is the rule about when you can recover a fee and the rules in my submission relate to the need to be able to regulate and the rules

are in the sections that we've been looking at. So it's not is how long is a piece of string, it's a rule.

Now on the other hand, the interest provisions are only subject to the oppression provisions and as has been I think been made clear on a number of occasions, the fact that you can't recover a cost or a fee just means that if you want to recover it, you recover it through the interest rates. So it's not as the submissions, the written submissions have sometimes suggested in the Court of Appeal and at trial that a creditor somehow can't recover a cost that they incur in the business. Of course they can. If they think that it's appropriate to recover it, they can recover it through interest. The effect of that of course is it will affect the headline interest rate and the sensitivity to that is clear in my friend's written submissions where he refers to, you know, why should MTF be required to put this into the interest rate and I can take you if need be also to a comment in the course of the trial to the same effect. Clearly MTF was sensitive to raising the interest rate and that's one of the factors driving putting it into costs, but on my submission that's exactly what the Parliamentary intent is, drive it into the interest rate except where it can be recovered as a fee for that very reason, that it improves comparability. It makes it easier for people who are not at all financially literate who are faced with all sorts of ways in which things are allocated into different fees and interest rates to see should I do that or that? They can then look at the listed fees in that loan agreement Your Honours were taken to by my learned friend. You can see the specific fee, this much for the establishment fee for MTF, this much for Sportzone, so you see the fees listed and they say, "Okay, well, they're charging me $200 for this establishment fee. Now, this other place that I've been to looking for a motorcycle, they only charge $100 but their interest rates are the same or they're this or that." Now, how well that will work in practice is another question but I do think that's the policy that we're seeing play out here.

ELIAS CJ:

I'm not sure how you can put all the weight onto the reasonableness of the fee and maintain that the policy of the Act is to put these costs into the interest component. It just seems to me that you have to make a more ambitious argument about what a fee can be in the scheme of the Act and if you don't make that then it is all – well, then it's very difficult for you to maintain the view that any cost is not – any cost shown to be reasonably connected is not appropriately charged as a fee.

MR MILLS QC:

Well, it means I haven't been putting it clearly because it is not my submission that any fee that's reasonably connected – that's what my learned friend says. I do not accept that as the correct interpretation of the connection required. My submission is that the connection, to use the sort of easy term that the Courts below used, it has to be triggered by, closely connected to, the activity for which the fee is charged. Now, it's been said that the Commission's position that only the variable costs – the Commission never committed itself to that. It was really the evidence played out and some of the experts said as accountants we would read that section, particularly section 42, as meaning variable costs. But then under cross-examination –

ELIAS CJ:

You know, I'm not worried about section 42. I think your problem is sections 41 and 44 unless you want to make a more ambitious argument that the indications in section 42 assist you in identifying what is appropriately the subject of fees under this because otherwise it looks as though as long – I mean, looking at section 44 and inverting the in relation to the matter giving rise to the fee and inserting the definition it seems to me that you really end up with a statutory provision that any cost to the creditor in relation to the matter giving rise to a fee payable under the credit contract by the debtor to the creditor can be charged and then the only question is whether it's reasonable.

MR MILLS QC:

Well, that's certainly not the submission I was intending to make.

ELIAS CJ:

Well, how do you – where is the line, as you said?

MR MILLS QC:

Well, the line in my submission under 44 – and I accept that it is differently worded, of necessity differently worded to section 42 is derived from what's a cost that is related to the activity for which the fee is charged.

ELIAS CJ:

No, the matter giving rise to the fee.

MR MILLS QC:

Yes, so the matter giving rise to the fee is the activity and to stick with what we've got here on the facts, the activity is maintaining the debtor's account. So what's the activity? We know what the activity is with section 42 because it's predetermined. What's the activity with the fee that the creditor has now chosen to use?

So account maintenance, the analysis is what's involved in account maintenance? What do you do? Once we know that, which is what the Commission has drilled into here, then the cost has to be in connection with, it's got to be in relation to the activity as cost incurred for that activity. In my submission, consistent with the Courts below, it is the same close connection test that the Courts have applied to section 42. In other words, section 44 does not allow all the costs of the business to be put into fees any more than section 42 does, and thus when we come to section 41, as we channel back to that for either of these fees, it's not just a question of is it any reasonable cost of the creditor's business? It is are you charging a fee that reasonably compensates you for the costs involved in the activity for which the fee is being charged? That needs to be interpreted against this statutory purpose of intending to constrain the use of fees for the purpose of making the headline interest rate a more meaningful basis of comparison to potential debtors. That's certainly my submission on how that works, so I certainly do not accept that a correct interpretation of section 41 in relation to section 44 –

ELIAS CJ:
So does that mean in terms of, say, account maintenance it's the – what goes into that? Is it encapsulated somewhere?

MR MILLS QC:
Well, first of all we would have to know what the particular creditor was saying they did under that account maintenance activity and so we've been told that here by MTF. So once we know those steps they're really the equivalent of the steps that are set out for section 42. This is what we do for establishment. This is what we do for account maintenance. Once you've told us that, then the question is what costs are you seeking to recover for the maintenance of the individual account and then the averaged amount over the wider group of borrowers. Then the question is do those fees that you're charging do more than reasonably compensate you, the creditor, for the cost of carrying out that activity for which you are charging the fee?

GLAZEBROOK J:

But you do accept that if they say, "This is the activity we do," that it may be that that isn't a reasonable activity?

MR MILLS QC:

It could be, yes.

GLAZEBROOK J:

Or certainly not in accordance with commercial practice and therefore is unreasonable per se, but once you – but in this case the costs that were identified were, in fact, related to the particular creditors and what they did in relation to that account.

MR MILLS QC:

Well, subject to the way in which they went about allocating costs.

GLAZEBROOK J:

Absolutely but that's your second step is the allocation of cost?

MR MILLS QC:

It is, yes.

GLAZEBROOK J:

So the first step is saying, "What is the activity? Is this activity one that can reasonably be charged in accordance with section 44 if it is, and that has to be related to the credit contract?" If it is, you then see whether the allocation of cost to it is reasonable so there is a two stage step. It's just in this case they did the account maintenance fee was four things that were related to the particular credit contract and something was reasonable to charge a fee for in terms of the broad statutory language that doesn't put too much – too many restrictions on what you can charge a fee for, although the managing director's retirement fund would probably, even on Mr Goddard's, would be outside of that.

ELIAS CJ:

I just don't understand why it is outside of that, really.

O'REGAN J:
Because it's not a credit fee as defined. A credit fee has to be something which benefits you in respect of a particular credit contract.

MR MILLS QC:
Yes, so of course here the issue really was about not could you – not could MTF legitimately say, "We do account maintenance and we are entitled to have a fee for account maintenance." The issue was, then, well, what do you do when you say you do account maintenance, the activity, and what's the costs that are incurred in doing that and what have you charged by way of account maintenance and if it's not a cost that is properly related to the activity then the answer under 44 would be it's not reasonable but it could still be measured against a reasonable standard of commercial practice which, as Your Honour said, would potentially make it per se unreasonable but what actually happened here was that there were all sorts of costs which were dropped into account maintenance which the Courts below held had nothing to do with account maintenance.

ELIAS CJ:
Yes, thank you, we'll take the adjournment now until 2.15.

COURT ADJOURNS 1.02 PM

COURT RESUMES: 2.22 PM

MR MILLS QC:
Thank you, Your Honour. Two things I wanted to come back to immediately. One is in relation to a matter that Justice O'Regan raised and another is the issue that you were raising with me, Chief Justice.

So just on the issue that Justice O'Regan was referring to, I just wanted to make sure that there was a, I say this carefully, that the full meaning of credit fee has been appreciated. I think my learned friend raised some concern with me as well about this, that it is quite a wide definition, "Not only fees or charges payable under but also for the benefit of," et cetera. And it comes back again to this way, "In connection with." Now, of course, what I say is that that wide term in connection there, when we turn to the credit fees provisions is narrowed down by the specific mandatory considerations we've been looking at. So that's the first thing I just wanted to note.

But, Chief Justice, the issue I wanted to come back to that you had raised with me as I thought more about it over lunch and thought about the concern you're expressing. Let me just make sure that I'm understanding your issue over this so that I'm answering the right question. My understanding of the issue that you've been raising with me about section 44 is that if it's correct that the types of fees that a creditor can charge for are, in effect, things that just get generated by the creditor saying well, we'll have a fee for this and a fee for that and a fee for that, then ultimately the result of that is that there's no real constraint on what costs a creditor can recover because the creditor can say well, we'll have a fee for –

ELIAS CJ:
Well they have to be reasonable that –

MR MILLS QC:
Subject to that, yes. But I take it that's –

ELIAS CJ:
Yes.

MR MILLS QC:
So let me see if I can give some more thoughts on that. The first one is that, of course, that that language in the credit fee definition about connection, that doesn't help us very much because that's the answer to that, is the very issue that's before this Court now about what does connection mean in the context of the fees provisions.

But if we start again, or if I start again, by going to section 44 itself, and this is going over old ground. I apologise. So the first question again is what are the activities under section 44? What's the matter for which the fee has been charged? And the way in which reasonable standards of commercial practice is currently found in section 44, that does place some constraint upon this question of the reasonableness of the fee itself. Is this matter for which the fee is being charged, is it reasonable to charge for that matter? So I won't bother with hypotheticals but I think that it would cache or at least give the potential to cache a fee of a particular kind, even though it was a credit fee, and say, "Oh, wait a minute. That's not a fee that complies with reasonable standards of commercial practice."

But, having said, and I think that for some purposes that could go both to the nature of the fee and to the amount charges. So reasonable standards of commercial practice I think could reach through to both the nature of the fee and to the actual amount.

ELIAS CJ:
Yes.

MR MILLS QC:
But section 41 undoubtedly remains the ultimate arbiter of whether a fee is unreasonable or not and in my –

ELIAS CJ:
If you had a creditor whose only business was providing credit on these credit contracts, all of the costs in running the business could come within section 44, subject only to reasonableness and whether it's within coo-ee of other commercial operators. That's the issue.

MR MILLS QC:
It is the issue and, as I said a moment ago, and as Your Honour, the Chief Justice, has just repeated, there are two ways of addressing that so as to constrain both the type of fee or the type of activity for which a fee is being charged so that it would be open to the Court under section 41 and also under section 44, reasonable standards of commercial practice, who'd say, this activity, this matter for which the fee is being charged, is not one that is either consistent with the reasonable standards of commercial practice under 44, or more directly under section 41, not a reasonable fee as to what it's trying to recover for. So it could do that.

And then obviously section 41 can also address directly the question of the quantum of the fee and whether that's a reasonable fee but in my submission, and this is just a repeat of what Mr Goddard's spent quite a lot of time on, in terms of the reasonableness of the fee itself, the first line of enquiry under both 42 and 44 turns on the meaning of connection, and does it mean that it has to be a connection of a kind that the lower Courts have described, in other words close connection, or can it be either the outlier interpretation or the beneficial relationship test? But to the extent that we're tying it to the generation of fees that the creditor wishes to charge for, that

that issue about whether this is a fee that it's appropriate to be charging at all, both as for content and amount, the burden for that is likely to fall, and certainly the Court will have discretion to address that under section 41.

ELIAS CJ:
But potentially all the costs of running the business could be the subject of fee on the approach that the Commission accepts?

MR MILLS QC:
You take that in two steps. On the fact of section 44, it seems possible to decide, we will have a fee that we will charge to the creditor for this activity and I notice that in one of the documents in the bundle and I wouldn't be able to put my finger on it now, was Kiwibank which showed all the different fees that they were charging and there's a lot of different fees that are listed down there and they're charging all of them. Now does that mean that because a creditor has said, "We're going to charge a fee for opening the file" that that allows any fee, including the overheads of the business, irrespective of the connection test? My submission on that is no. Once again it is subject to this question of what does it mean that it be connected to or related to the activity. To the extent that the naming of the fee opens the door beyond that, it can be closed again under section 41. But the fundamental question before this Court, as I understand it, is the –

ELIAS CJ:
Well it just seems to me that the only basis for challenge then is reasonableness of the extent once connection is established.

MR MILLS QC:
Well the meaning of connection though is going to define that extent, is these arguments certainly that I'm putting to the Court.

ELIAS CJ:
Well I was postulating a business which only provides credit.

MR MILLS QC:
Which is MTF.

ELIAS CJ:
Yes.

O'REGAN J:
But the Commission still say it can only charge its variable costs though, not its fixed costs.

GLAZEBROOK J:
Well variable costs are whatever is closely connected.

ELIAS CJ:
But what in the statute prevents that?

MR MILLS QC:
Well what prevents it at the moment at any rate, is the way in which the Court still have interpreted the connection and that is based on, at least in the way in which the argument has developed, is based on the careful crafting of the cost fee connection, the discrete way in which it's tied the certain steps, the statutory purpose of ultimately constraining cost recovery through fees in order to make comparability through the headline interest rate more effective. So that's the background which I think is there.

ELIAS CJ:
Well I know that that's the way it's been put but I'm trying to pin down in the statute what does that. You say it's all done on the connection.

MR MILLS QC:
The question of the connection is central.

ELIAS CJ:
To the activity.

MR MILLS QC:
Yes the question of connection is right at the heart of this, what does it mean and I wonder – I hadn't intended to do this but I wonder if it is worth taking Your Honours to what I think is the most useful of the various judgments on connection that are contained in the bundle. Just bear with me for one second as I cherry pick through this at this stage. It's the *Hatfield v Health Insurance Commission* (1987) 15 FCR

487 decision and that will be in the case bundle, my friend's case bundle and it is at, oh sorry it's in our one. So it's the respondent's bundle of authorities at tab 7. Now the facts here probably don't matter overly. It was about the withholding of payments to a doctor from the Health Insurance Commission on the basis of a criminal investigation that was under way related to previous payments. The Judicial Review Act under which this was proceeding entitled the doctor to a statement about what the connection was between the criminal investigation, that was the effect of what was being sought, a statement about the basis on which the judicial review – the basis of the reason so that the doctor could know what the issue was for the judicial review proceedings and it was held that a relevant connection had to be shown by the Health Insurance Commission before the decision that had been made to withhold these payments and so the question is what does this mean in connection with in this context and the discussion about that is principally at page 491. So it's a decision of the New South Wales Federal Court, Federal Court New South Wales registry. And you'll see there, beginning at the top of page 491 that the Court says this –

ELIAS CJ:
Well look I've already skimmed through it and it's really just saying it's contextual.

MR MILLS QC:
It is, yes it is.

ELIAS CJ:
What I was inviting you to show me is what, in the context of the Act, I think I understand your argument but it's simply the words or which words are you relying on? It's the in relation to the matter giving rise to the fee or is the definition of credit fee?

MR MILLS QC:
Well it's the purposes of course is where it starts, that we're talking about the purpose of enabling consumers to distinguish, the comparability issues, the apples for apples which Justice Priestly talked about, the rules about interest fees that are dealt with in the purposes section. So it's that background material buttressed by the other legislative materials that my friend took you to and obviously there's a number of those which I am not going to repeat but they're there.

ELIAS CJ:

Is there anything that you can point to in the Act which means that you can't just charge the whole of your business costs?

MR MILLS QC:

You're asking me specifically about section 44, not section 42?

ELIAS CJ:

I'm asking about section 44.

MR MILLS QC:

All right, well there is only the text of course but the text sits in a particular context as I've submitted before, the analysis certainly that I am standing here presenting to the Court and which persuaded the Courts below at least, is that section 41 comes after the analysis has been carried out under 42 or 44 whichever one is at issue and that in all of these sections, 42, 43, 44, 45, the question of costs and what costs are recoverable is at the heart of legislative focus. So when we come to section 44 it is the costs in relation to the activity for which the fee is being charged. Now Your Honour says to me well which costs? And it's correct that –

ELIAS CJ:

No and which activity? Where do you get the word "activity"?

MR MILLS QC:

Well the activity is yet to be defined. The activity, of course, under section 44 is not yet defined.

ELIAS CJ:

I think we're not getting anywhere. Don't worry. Sometimes there is legislation that breaks your head because it doesn't contain anything but I find it very hard to get from the legislative scheme the limitations that you are contending for.

MR MILLS QC:

Well then we're back to having a relationship which in my submission will not draw enforceable lines around what can go into fees.

ELIAS CJ:

Well which is why I suggested that perhaps there either had to be a more ambitious argument based on the whole structure of these provisions or there is no line that's very easily drawn and that it does all come down to what's reasonable in a particular context and the particular fee.

GLAZEBROOK J:

If you want to start, why don't you start with credit fees and the definition of credit fees because it has to be in connection with a credit contract.

ELIAS CJ:

Yes I agree with that.

GLAZEBROOK J:

And it has to be to or for the benefit of the creditor. So it doesn't say in connection with the business of providing finance for instance which might in itself provide that limit.

ELIAS CJ:

But it's not being suggested that the costs, that they are limited to the – you're not contending that it's limited, the costs are limited to the particular transaction in the particular – you're permitting some averaging of costs.

MR MILLS QC:

Yes, but only after the initial focus. I have clearly not been very clear about this. The initial focus is on the transaction. The matter giving rise to the fee is really the focus of this. It's only after that has been identified that averaging occurs. You can't average out of nothing.

GLAZEBROOK J:

Well can you average under 44?

ELIAS CJ:

Well, that's the question I'm really raising and that's why I'm saying a more ambitious argument might have been that there was –

GLAZEBROOK J:

You can under 41.

ELIAS CJ:

- specific reference in 42 to averaging –

MR MILLS QC:

Yes.

ELIAS CJ:

Does the fact that there is no specific reference – is the fact that there is no specific reference in 44 significant? But that's not an argument you're putting forward so we might as well move on I think.

WILLIAM YOUNG J:

Can I ask you perhaps what may be a related set of questions? If you look at section 41?

MR MILLS QC:

Yes.

WILLIAM YOUNG J:

One can have regard to whether the fee – how the fee refers to the creditors' reasonable costs in connection with the application for credit, et cetera, et cetera.

MR MILLS QC:

Yes.

WILLIAM YOUNG J:

Now that could be, could contemplate an entirely bespoke setting of a fee. This is a particularly difficult credit application. We've had to do this. We've thought about it. We've spent hours and hours on, so we're going to charge you $500. And it's different from everyone else, so it's ready – we're distinguishing. And then if you look at (b), it enables you to do that on a class basis.

MR MILLS QC:

Yes.

WILLIAM YOUNG J:

So this is a line of credit where there's already a mortgage. We don't need to worry about additional security so we've already charged next to nothing for setting up the facility. On the other hand we may have to establish a security specific to this transaction and, therefore, we'll charge a higher fee. But is it possible to extract from that, that these fees are intended to be, in a sense, tailored to the circumstances of the particular transaction or to a group of transactions which has particular characteristics which makes a fee out of the normal appropriate?

MR MILLS QC:

Yes.

WILLIAM YOUNG J:

What it doesn't say is everyone gets charged the same fee.

MR MILLS QC:

Yes.

WILLIAM YOUNG J:

Now, presumably this Act applies to banks providing their lending to individuals.

MR MILLS QC:

Yes.

WILLIAM YOUNG J:

So they probably have quite complex and differential fee arrangements.

MR MILLS QC:

Oh, that's the Kiwibank one that I mentioned.

WILLIAM YOUNG J:

Yes, are closely calibrated to the circumstances but what it may be is that it just doesn't contemplate everyone being charged $200 for setting up the loan no matter how big or how small it is?

MR MILLS QC:

No, well I don't think it does. And I think I'm in agreement with the way you've put it, Justice Young. The initial focus, certainly the submission that's been made all the way through for the Commission, and accepted by, so far anyway, by the Courts below, is that the credit fee cost assessment is focused at least initially in the legislation on the individual. It's this credit application and the cost on that and it's made very clear, I think, by the use of the definite article and then as Your Honour has said, that it would be – there's two ways of doing this. One is you could just stop at 42(a), for example, and you would charge for that specific transaction based on the standard that's set there. But alternatively, and it will be obviously what everyone in this business does, there'll be an averaging based on an appropriate class which people are put into. You say, well, this is the average for that class. The class is an appropriate one and we'll then average what we see as being our costs over a certain period of time. We've analysed them and some are up and some are down. We'll average it across an appropriately identified class but it is costs in connection with the individual transaction which provides the basis for the build up, and it's costs connected to that specific transaction.

Now I've said this many times but in the case of 42, the nature of the activity is defined. They're the four steps of establishing a loan. In the case of section 44, they're not yet established but they do get established as soon as the creditor says this is the activity for which I'm going to charge the fee.

WILLIAM YOUNG J:

Yes but corollary of what I was putting to you is that there is no scope under this section for charging standard fees to everyone.

MR MILLS QC:

Well –

WILLIAM YOUNG J:

Because everyone can't be a class of – every contract they enter into can't form a particular class of contracts can it?

MR MILLS QC:

Well it would depend on the nature of the lending business I think. If you look at, for example, what MTF was doing, it's all pretty standardised stuff.

WILLIAM YOUNG J:

Yes, that's right. So that there’s no need for bespoke fees. There’s not need to distinguish between different groups of contracts.

MR MILLS QC:

Not for this creditor.

WILLIAM YOUNG J:

No. On the other hand we’re looking at the case very much in terms of MTF, but if you’re a bank well, it may be very easy to define different groups of borrowers.

MR MILLS QC:

Yes, there very well might be and some of the things that would distinguish them would be the matters that Your Honour referred to.

WILLIAM YOUNG J:

And that would enable effectively a competitive price to be set, a price that’s referable to, not just the time value of the money that is advanced but also what is required to set up this particular contract as opposed to other contracts.

MR MILLS QC:

Yes, but it still requires a question of the nature of the connection between the cost and the fee to be addressed, and what we’ve got so far is a view that what qualifies is, in accountancy terms, variable costs that will always be sufficiently connected but then the Courts below have said, “In addition, depending upon how –

WILLIAM YOUNG J:

But in a way, why, if they’re just standard fees that area applied across the board to everyone, because these are just standard fees, aren’t they?

MR MILLS QC:

No, they’re intended, or at least on the submissions that I’ve been putting forward –

WILLIAM YOUNG J:

No, no, the fees that MTF charged? I mean it’s always $190 –

MR MILLS QC:
Yes.

WILLIAM YOUNG J:
- for every establishment fee in the year in question.

MR MILLS QC:
Some variations in the loan documents but generally it seems to be around about that.

ELIAS CJ:
The variations are over time aren't they?

MR MILLS QC:
No there's some which have set, and I'm not sure why, lower establishment fees than others but generally they follow a pattern and, of course, the actual retailer, Sportzone here, could set their own establishment fee but they were giving guidance, as I understand it, as to what that – well, it shouldn't be above a certain figure and, again, it tended to be pretty standardised as you can see in the loan documents. But the question is always, in this case, does this allow every overhead of the business to be put into a fee or is it, as the Commission has been contending and as the Courts below have said –

WILLIAM YOUNG J:
But it might actually allow nothing to go into the fee if there is nothing particular about the particular borrower or the class of borrowers that that borrower is a member of.

MR MILLS QC:
Well, I agree. There's got to be a cost in carrying out the activity for which the fee is charged. If there isn't you can't just charge a fee.

GLAZEBROOK J:
Well, I think what's being put to you if it's just a standard amount it should go into interest rather than be allowed to be put into a fee. It's not something I'd necessarily subscribe to but certainly in terms of the variable cost idea, if you have two borrowers or 50 borrowers, your overheads might be exactly the same. The 51st borrower might

incur a whole pile of extra overheads because you can't – you could service 50 with those overheads but you can't service 51.

MR MILLS QC:
Yes.

GLAZEBROOK J:
But the variable cost will always be an amount that will be for each particular borrower and if you look at it just in terms of paper, if we're looking at a paper application, it will be the paper – it will be the piece of paper that they have to fill in. Not that we do paper anymore but there will always be, or likely be, a variable cost for each additional person but there will be lumpy additional costs for overheads.

MR MILLS QC:
Yes, and I suppose the, again, can one – is one entitled under the Act to take those variable, variable costs of the transactions that have been carried out and averaging them and it does say, "The reasonable costs of the matters referred to in paragraph (a)," that's been seen to suggest a cer –

GLAZEBROOK J:
There's nothing in 44 that allows averaging, is there?

MR MILLS QC:
No, there's nothing specifically that says that but it would be, I would have thought –

GLAZEBROOK J:
Well, especially as it's a prospective it's a bit difficult not to average it.

MR MILLS QC:
Indeed and it does talk about estimates and it's also subject to reasonable standards of commercial practice. It's certainly never been the Commission's position that the interpretation of this, even though it's initially focused on determining a cost for an individual transaction, that that counts as a practical matter within the language of section 44 permit this to be done by way of forward estimate where fairly standardised fees are charged. The big issue is over what can go into those fees.

In case it helps, I've just been told to identify the specific passages in the legislative history that do give guides as to what's intended here and so I just mention it to you. It's appendix 1, actually, which Your Honours haven't been referred to. This is part 3 of my friend's bundle of authorities and it is at tab 19. This is the consumer credit review. You'll see that –

ELIAS CJ:
Well, we didn't let Mr Goddard take us to this. It seems to be a bit unfair, really.

MR MILLS QC:
I thought he was allowed to. I'll tell you where it is and for what assistance it may or may not offer to the Court, you'll see at page 70 there is, as part of this process, there's been an analysis or an assessment of how lenders' costs are recovered in the absence of any regulation. That has been part of the thinking of how this is all done and I just leave that for the Court out of interest. In general, I think it's fair to say that what this reveals is that it anticipates that recovery of costs will be through fees where they are specific to the loan in question.

GLAZEBROOK J:
That's what's said in the explanatory note as well, isn't it?

MR MILLS QC:
Yes, it is.

Now, just out of the limited time I've got, what I wanted to do was to try to give you a few things out of the evidence which really underpin some of the points I've been making more generically. The first of these is in volume 8 of the case on appeal. I take you to this because my learned friend has been unkind enough to characterise the view taken by the Courts below and by the Commission as absurd in the connection that's been required and so what I'm taking you to are some emails involving the MTF senior staff when they're trying to make decisions around the connection. You'll see at page 1514 that –

ELIAS CJ:
This is what was in their mind. How does that help us in interpreting the Act?

MR MILLS QC:

It goes only to this question that this meaning that's been given is absurd but what these show is that that connection, that direct connection meaning which is said to lead to absurd results was exactly what was the interpretation that at least at this stage was being taken by some of these senior people at MTF, that's all.

ELIAS CJ:

Well, all right. I mean, it seems to me a matter of colour rather than something that's going to help us.

MR MILLS QC:

It may well be. So there it is. You'll see that 1514, the exchange, it's this initial fee review process being run within MTF by Blair Harrison who, I think, is the CFO at the time, and so under this heading of "fee types allowed" after talking about what they have to do with this new Act you'll see under "establishment", the second paragraph, "The fee should reflect only costs you can directly attribute to processing, considering or documenting a consumer credit contract," so that's the view that's now said to be absurd, as I understand it.

ELIAS CJ:

But that's really what establishment fee under section 42 seems to envisage.

MR MILLS QC:

That's certainly my submission. It's not the view that's accepted by my learned friend.

Then down at the bottom of the next page dealing with credit fees generally – this is the section 44 issue – you'll see right at the end there, "If you charge a credit or default fee under a contract you should ensure you are able to justify it having regard to the costs of losses that gave rise to the fee." So it's the meaning that I've been pressing and evidently not considered absurd in that analysis.

Then the next thing I wanted to take you to is the evidence of Dr John Small. This underpins the submissions I made earlier about the underlying policy for this strictness around fees and the liberality around interest. You'll find that in volume 6 at page 917. That's where it starts. He gave evidence – and probably the thrust of the evidence I want you to see begins, I think, at 924, where he's talking about the

way in which creditors tend to try and shroud their real fees by complexity of charging structures.

Then paragraph 39, he references his understanding of the CCCFA in the way it works and he says at the end of that paragraph, "Limiting fees for the recovery of variable costs is likely to assist consumers by focusing price competition on interest rates as the headline indicator of prices and may also protect consumers directly by reducing the likelihood of lenders extracting super-competitive profits," and he continues on in that theme and then at page 929 he deals with asymmetric information which is another one of the concerns that comes through in the background materials to this Act and he says there at paragraph 65, "It is widely acknowledged the competition in markets for credit contracts is hampered by information asymmetries."

Mr Mellsop, who gave evidence for MTF, accepts this and it refers to his evidence, but he devotes most of his efforts to the difficulties these asymmetries may cause for suppliers of credit contracts. He goes on and deals with that and ultimately says at page 931 in his conclusion, paragraph 76, "In my opinion, limiting fees to variable cost would be likely to protect consumers from creditors extracting supra-normal profits through fees by providing a degree of standardisation across fees. Such limits are also likely to enhance the ability for consumers to compare credit contracts compared to an arrangement where fees could be much higher than variable costs and could vary considerably between suppliers, that a comparability would, in my opinion, protect consumers by increasing the intensity of competition between the suppliers and credit contracts."

ELIAS CJ:
What was this evidence directed at?

MR MILLS QC:
It was – well, it came first of all because expert evidence was being called by the other side so we decided we needed this.

ELIAS CJ:
So what – all right, well perhaps I should just say what use do you suggest we make of this?

MR MILLS QC:
It goes to the question of the policy that I am submitting underpins this aspect of the Act and endeavours to anchor the rationality of that policy in this canvassing of the literature and the economic theory about price comparability and the adverse effect in consumer markets of having no constraints over fees. So it's really underpinning the policy that in my submission is derived from the Act and addressed to my friend's argument that there is no coherent policy underneath the argument that the Commission is putting forward and the Courts below have accepted and it is essentially absurd. So this is what this is directed at.

Then the next thing I wanted to just make the Court aware of and I do no more than that, particularly with the time, is the timetable for the Select Committee process related to the 2014 amendment and what benefit Your Honours ultimately get or do not get from the amendments that came through in 2014 is of course a matter for Your Honour's consideration but what I do want you to know is that the Bill itself had its first reading before the liability judgment in the High Court was delivered. The first reading of the Bill was 17th of September 2013. That judgment came out on the 27th of September but the liability judgment was a live issue in the Select Committee hearings. Now there are good authorities for the Court looking in certain circumstances at Select Committee hearings and there are also good authorities for a Court having to consider an ambiguous provision in a statute. Getting some assistance from the way in which those provisions have been dealt with subsequently. Not because they changed the earlier law but because they signalled some clarity about what was meant by it and if it's of any assistance to the Court –

ELIAS CJ:
Well what do you want us to take from it and you're not taking us to any case law on this sort of material being used in statutory interpretation.

MR MILLS QC:
It's referred to in the written submissions. If there were time I would take you to it but I will if I have to just use up the time I've got with that but if I can just sort of foreshadow this initially. There is, as Your Honours will be probably even more aware than I am, there is sensitivity around the question of the extent to which subsequent legislation addressing an issue with a judgment, a Court judgment has dealt with, can have any relevance to a consideration of the legislation that they're now dealing with. The proposition that I would put forward on this which is drawn

from a couple of cases that I'll give you the names of in a moment, and it's referred to in the latest edition of Carter and Burrows on Statutory Interpretation, is that where you have ambiguity in a statute, meaning diverse views can be held of language which clearly we have here, then if there has been a subsequent, what I would call signalling by parliament in some way, that a particular meaning of that ambiguous provision is the preferred one, then it's entirely appropriate for the Court in its discretion to take account of that. Now that's the proposition and the cases – there are some cases referred to in the written submissions but when I looked at this more closely myself I thought that the cases that are the ones that I would point to in relation to that are these, and I am sorry not to have this in the written submissions, but would you like me to give you the references?

ELIAS CJ:
Yes, thank you.

MR MILLS QC:
The first of them is an old case, *Attorney-General v Clarkson* [1900] 1 Q.B. 156, Court of Appeal decision in the UK, and it is 1900 Queen's Bench, 1 Queen's Bench, at page 156 and what the Court said there, in summary, and it was on the question of whether there was a settlement within the meaning of the legislation when it was only contingently settled, and what the Court said was it's ambiguous; it's a nice question as to what the right answer to that is, but there had been a previous Court decision which had adopted one meaning and then there'd been subsequent legislation which had proceeded on that meaning and so what the Court said there, in summary, was, "Parliament's adoption of a meaning was now the one in this ambiguous provision which this Court should accept."

The next case that I looked at is a case, another English Court of Appeal case called *Cape Brandy Syndicate* –

ELIAS CJ:
Sorry, that's simply a determination that the Court should follow an earlier interpretation because subsequent legislation had proceeded on the basis of that interpretation, is it?

MR MILLS QC:

Yes, but the particular provision now being dealt with is being – which the Court is saying, “Well, you know, we think could go either way,” but because there’s an indication, it didn't bind on, in relation to the statute the Court was interpreting, because that was in place at the time of the event and so what we’re getting is a subsequent amendment which signals that a certain meaning was the right one for the Act that the Court is dealing with. The Court’s saying, “Well, it wouldn’t have to follow that, because it’s not binding on us,” but the Court has had a signal from Parliament that in the context –

ELIAS CJ:

Well, I don’t have any trouble with that.

MR MILLS QC:

All right.

ELIAS CJ:

As a canon of interpretation.

MR MILLS QC:

Yes.

ELIAS CJ:

I mean, Courts do that all the time.

MR MILLS QC:

Yes, well, that’s what I thought.

ELIAS CJ:

Say, there’s been a settled meaning, Parliament’s proceeded on that basis.

MR MILLS QC:

Yes, all right.

GLAZEBROOK J:

Although this is slightly different, because it’s interpreting the previous legislation before the amendment, which had –

MR MILLS QC:
That's right.

GLAZEBROOK J:
- has often been said, you can't possibly do that because Parliament may have been changing the meaning, so if you –

MR MILLS QC:
Yes, yes, it's in that context.

GLAZEBROOK J:
If there's a possibility that Parliament might have been changing the meaning, rather than adopting the previous one.

MR MILLS QC:
Yes, yes, that's been the concern around this, and so that's the issue that this is addressing and saying in appropriate cases you might get a signal as to what the meaning of an ambiguous provision is. And I also just mentioned to you the other one, second one, this is *Cape Brandy Syndicate v Inland Revenue Commissioners* [1921] 2 K.B. 403 where, again, we have ambiguity which is seen as the pre-condition. It's about the wartime profiteering provisions, and so the Court is interpreting a particular Act and it's an ambiguous provision. We have later legislation which assumes a particular meaning and the Court says, "Well, given it's ambiguous and we've got later legislation that adopts a particular view, we should take that as a signal that we should interpret the earlier Act in accordance with this latest signal from Parliament. So, it's a similar point to the previous case.

And then the final one that I looked at, which is more –

ELIAS CJ:
Sorry, so that is, is that simply reading the whole statute book, that, that sort of approach?

MR MILLS QC:
No, it's looking at, so we've got an, an Act in 1915, I think were facts here, where, which is the one under which these charges have been laid on the grounds that profiteering has occurred and duty is paid at a profiteering rate. Then, we have

ambiguity about whether this conduct is caught by that Act or not. We then have later legislation, because it seemed to be being done on almost a yearly basis in the war and post-war period. We then have subsequent legislation which gives an indication that the correct interpretation of the 1915 Act is this meaning and not that meaning and the Court again says well effectively that's a signalling to us that that meaning in the 1915 Act is the one that we should adopt. So different legislation, it's not actually an amendment to the legislation that's in front of the Court, it's a signal to interpret an ambiguous provision in a particular way. And the final one that I looked at doesn't have an official citation, it's a case called – I call it *ZYN*, *R (on the application of ZYN) v Walsall Metropolitan Borough Council* [2014] EWHC 1918, [2015] 1 All ER 165. It's about personal injury compensation and how much of it could be clawed back by the local authority for payment for the person's care and its neutral citation number [2014] EWHC 1918 again it's in that same kind of –

GLAZEBROOK J:
Is that the allocation one between different local authorities or is this a different one?

MR MILLS QC:
This is the one that dealt with whether somebody who had received a compensation settlement approved by the Court, whether that was included in the amount that the local authority was entitled to claw into for that person's subsequent care and there was ambiguity in the legislation again but again later signals as to what meaning should be given to those ambiguous provisions.

GLAZEBROOK J:
I was thinking of a different one I think.

MR MILLS QC:
And so it's in that context that there are some statements in the legislative materials for the 2014 amendments which are in our supplementary bundle which do I think signal that this connection that has been contended for here with the intent of focussing competition on the headline interest rate, can be seen. What this Court makes of that I don't press the point further other than letting you know that it's there.

ELIAS CJ:
Well what's your submission on it? You're just saying it's there for you to make whatever use you want of it. It's difficult to know what you want us to take from it.

MR MILLS QC:
Well I say that only in relation to the sensitivity and the divergent views around its admissibility. My submission is that it is and that it is admissible and let me take you then to the particular parts.

ELIAS CJ:
Well I'm just trying to understand what the submission Mr Mills, it's a bit Delphic.

MR MILLS QC:
The submission is that it supports the submission around the connection that's required and that it needs to be the close connection that the Courts below have insisted on as being the correct interpretation and that because the High Court judgment specifically the subject of submissions to the Select Committee, the changes that parliament did not make could be seen as having some relevance and the material, and I'm just looking for the specific provision in the Select Committee report. This is our supplementary bundle, it's the beginning of – it's not our supplementary bundle, this our bundle of authorities beginning at tab 1 through to tab 5. It's all the background materials, including the new Act, parts of the new Act at any rate.

ARNOLD J:
And is this the material you summarise at 3.36 and following?

MR MILLS QC:
Yes it is, yes it is and so one - the only specific passage I draw you Your Honour's attention to which I do think is relevant is under tab 4, this is the report from the Select Committee. Actually I draw your attention to *Hansard* as well. So the report from the Select Committee at page 9 under the heading, "Other credit fees and default fees" and this deals with the reasonable standards of commercial practice which was taken out in the Bill and then came back in again and there's two aspects of that I draw your attention to which is at the bottom of that page. The first is our amendment confirms and makes it clear – so it's reaching back – confirms and makes it clear that reasonable standards of commercial practice are not intended as a separate basis for calculating credit or default fees but only to inform the main test – and this is the second limb that I draw your attention to – which concerns costs and

losses which, I suppose, is just to state what's in the section but it is emphasised there.

Then in the report on the second reading which is at tab 5 you will see the Minister of Consumer Affairs and over on the second page there is a mention at the bottom of that page about the policy intent being directed particularly to vulnerable consumers and actually you will see, if you look at the Act itself, it has expanded on the policy purposes provisions in the new Act. But over on the next page about half way down he addresses the question of fees and he says this. "The fees provisions, particularly the provisions relating to unreasonable credit and default fees, have been a controversial area over the Bill. Submissions on the Commerce Committee stated that the provisions needed work. The committee has recommended that the Bill made it clear that fees are constrained by reasonableness tests and that the test is anchored in the principle that fees are a means for creditors to recover costs. This is consistent with the policy intention of the legislation as it currently stands," and so on.

And there is some further discussion by another member of the select committee, Jonathan Young, which is at page 17204 where there is some further discussion about vulnerable low-income people, third tier lenders and so on, but that's just to reinforce what I think was clear from the outset with the initial Act.

So in my submission the 2014 legislation adds force to the correctness of the decision that has been – that is under appeal.

One other thing that I think the Court needs to be aware of in relation to those amendments is that the definition of creditor has been amended. Now, the reason I mention this is because my friend's written submissions have a number of scenarios which predict consequences in relation to third party lending which is said to mean that this interpretation simply can't be right that the Court is faced with here. There's been a change to the definition of creditor and it's in the – sorry, a change to the official credit fee and it's under tab 1 of the bundle but what I just draw to your attention is that the effect of it is to link a section 45 third party fee to the associated person definition which has always been in the Act with the result that if the third party under section 45 is an associated party of the creditor then it's made subject to section 41 and because the consequences my learned friend is pointing to relate to the future it's a relevant factor in considering that and certainly in my submission it addresses three of the scenarios that have been pointed to my learned friend and

they are B, C and D. I'm being told there's a hand up so there's the amended definition of credit fee.

Your Honours the next thing I wanted to take you to in the evidence is in the case on appeal at volume 6 and I'm doing this, again as I say, to try and anchor some of the statements that I'd been making earlier into some evidence and this is part of the cross-examination of Mr Lont or Professor Lont who is the accounting expert called by MTF and the relevance of taking you to this is that he's giving evidence here at page, it starts at 966 but it's beginning – the part I want to take Your Honours to begins at page 1073 and he's being questioned about the beneficial relationship test and the point I want to bring out of this is that in the end – and the point that I wanted to bring out about this is the ultimate position he comes to that the beneficial relationship test is so vague in the end that it's subjective and different views can be held on what's beneficial connected or not and this goes to my submission that this cannot be the correct meaning of connection under the statute because it doesn't lend itself to the statutory purposes, including effective regulation. So I asked him at page 1073 about cost drivers and he said, "This idea of beneficial", this is at line 19, "is how the cost object benefits from that activity."

And then over on the next page at 1074, I asked him a series of questions about connections and so on and he says down at line 15, he's talking about his beneficial relationship test, "So it's about looking at is there a benefit, can we trace that. If we can't trace it, well then we look at the beneficial test." And I said to him, "Yes and I think we agreed before the break once you get into those sorts of issues there's potential for quite a lot of subjectivity and differences of view amongst accountants." And he says, "Of course." And then I asked him various questions about different drafting of the statute and whether that would make a difference, none of which I need to take Your Honours to and over at 1076 at line 25, he said, "The problem with the beneficial rule test is that, as I think as has been pointed out as a fair comment, that it's not well defined in the cost accounting standards." And then over on the next page I was asking him specifically about the four steps in the establishment fee process and I said to him at page – at line 8, "So as far as you're concerned if you were told that the only costs that can be recovered for those four elements of the establishment process we looked at before the break, are costs that are closely related to those four steps and that activity, would you regard a beneficial connection as being sufficient to meet that test?" And he said, "I would say no, that's a cause and effect relationship." And then at the bottom of the page I said to him, "You've

said that, I think you've said to me that what you're looking for with this language is a cause and effect connection, correct?" And he said, "Ideally." And so where this ended up was with the acknowledgement that the beneficial relationship test ultimately is reached for when you can't find cause and effect and it's vague and it's subjective and lends itself to a variety of different views.

There's a similar line of discussion with, or cross-examination with Mr Todd, who's the senior at MTF, and that's in volume 3 and, again, just to – so the Court's aware of the difficulties with seeing this is the statutory test; you'll find that in volume 3 at 514 and beginning at around about page 514, Chief Justice, beginning around about line 16. So, he's talking here about the way in which they allocated the costs, the different cost pockets and I said to him, in line 16, "You agree with me that even taking the very broad, what I would describe, anyway, as a very broad definition of connection, certainly the Commissioner would describe it that way, that from time to time you still had some difficulty feeling comfortable that you had found the right connection between the cost and the fee that you were trying to put a cost into."

And then down the bottom of that page he said, "Yeah, so that's why we didn't feel that we could categorise that by, you know, by establishment and settlement and arrears, so it's, sort of, we've defaulted that to our maintenance category." So, that's how they went about it, and at the next page he says, "Well, we still had to make a connection, but clear they were acknowledged, as they were having real difficulty with this," and then over on page 516 I asked him, I was asking about activity based costing, which is the methodology they used, and he said that the activity based costing is subjective, he said, "It's about arbitrary allocation, so there's always more than one way of looking at it and one way of doing it."

So, again, as a statutory test consistent with the purposes that I've certainly submitted to the Court, the evidence is that it does not lend itself to any clear standard. Now, again, because I'm very conscious of the time here –

ELIAS CJ:
We'll take a break at 3.30 and continue after that, thank you.

MR MILLS QC:

All right, okay. The next passage I wanted to go to is from the evidence of Mr Kensington, who was, really, the MTF witness equivalent to Mr Cregten, and that's in volume 7. It may well be that that's, we get to that and that's where I pause.

So, this is my, what I want to take Your Honours to begins at line 26 of 1302 and what's being dealt with here is the way in which Mr Kensington had re-allocated to different fees from the ones that MTF had allocated its costs to, so it's related to the point I just took you to in Mr Todd's evidence about that default into the account maintenance fee when they couldn't find anywhere else, and so because the door was being opened to being allowed to re-allocate after the event costs that had been wrongly allocated, principally to establishment fee, so Mr Kensington was going through this exercise and doing the re-allocation, and at line 26 I said to him, "So, then, to generalise it, you agree with me that there are several costs, or several fee categories, where a cost has been allocated to them by MTF where you've concluded that there is an element of cost that shouldn't have been allocated to that fee category?" "Yes," he said.

And then, over on the next page, after some argy bargy, line 11 he said, "I'd have to say that I believe that they should have allocated them differently." And I asked him, "So you're disagreeing that the allocation was one that was properly made to a particular fee, that's why you've reallocated isn't it?" "It is, yeah, it is."

Then through to page 1305, you'll just see some examples of that and so at the top of that page he had – MTF had put 100% of their premises costs, their total costs for premises into account maintenance and he had disagreed with that, applying a test of whether it was obviously connected to that or to something else and he said it's obviously connected elsewhere and the next one I took him to down at line 30 was the establishment issues and the first of these was bank costs over on the top of the next page and MTF had allocated 100% of the bank costs in 2008 to establishment and eight percent in 2006 and '07. I think that's accurate. And again he was disagreeing and I put it to him at line 9, "So in other words in 2008 MTF allocated somewhere between 90 and 95% more of those costs to establishment than in your view they ought to have done?" "Sure", he said and then on the directors costs again he had reduced that allocation and again he agreed that, down at line 20, "In other words in 2006 and 2007 it would follow from that, wouldn't it, that MTF had allocated 30% more of the director's costs to establishment than you regard as correct?"

"Yeah." And that went on through quite a lot of the different allocations and again the reason I draw Your Honours' attention to that is because of the weaknesses it shows in the beneficial relationship test which is what he agreed he too was applying as a statutory test in connecting costs and fees consistent with the statutory purposes.

COURT ADJOURNS:3.32 PM

COURT RESUMES: 3.49 PM

MR MILLS QC:
Thank you, Your Honour. I just have a few more things; I won't take much more time.

ELIAS CJ:
Well, we're going to sit on, so how much longer would you like?

MR MILLS QC:
I – well, my friend had –

ELIAS CJ:
I had hoped you might finish by about 20 past three.

MR MILLS QC:
I'll certainly be done by then.

ELIAS CJ:
Twenty past four, sorry.

MR MILLS QC:
Yes, certainly be done by then, I'm hoping to be done earlier. I have my eye on a plane that I have to change the flight for.

ELIAS CJ:
I see.

MR MILLS QC:
My friend tells me he'll be 30 minutes, so I think I might be in deep trouble, but anyway, then I'll come to the reception.

ELIAS CJ:

Well, he may not have 30 minutes, he may have 20.

MR MILLS QC:

So, the next thing I wanted to take Your Honours to, again, is in the evidence and it's volume 7, Mr Kensington, I think, is where we were, but now we're at 1295 and I'll tell you why I'm doing this once you get there.

O'REGAN J:

1295?

MR MILLS QC:

1295. The point I go to this for is Mr Cregten's acceptance, which you will see beginning at about line 24 and then over on the next page, that it was the issue of interpretation that divided his numbers from Mr Cregten's. I was going through a line of cross-examination with him, I think this is about the beginning of, yes, it is, where I was trying to find out what matters we agreed on and this was one of them, and I said to him, after a number of questions leading up to it at line 24, "So, yes, there's a range, but the reason for the different view you've taken from Mr Cregten is because of a different view about what the Act is saying that range is; that's right, isn't it? Answer, "If you're saying it's a difference in the way of interpretation of any connection and," and I said, "Yes, I am," acknowledged that, and I then said, "Yes, yes, and so if you're right, then it will probably follow from that that your percentages are right and if he's right it probably follows that his percentages are right, and over on the next page he said, "Yes," but with a slight qualification, "That this is an area like in cost accounting, where, you know, my allocation is my allocation. There is still probably some room for another person who did it my way to have the percentages," but then you'll see how relatively limited he thought that range was. "I might go 70/30, they might go 65/35," and as I think you're aware, the experts put forward high and low ranges applying their own tests, but, and then he went on, and I said to him, "So, these are your high and low ranges for example?" "Sure," "And if Mr Cregten has done the same thing with high and low ranges," "Yeah," "And that reflects that there's an element of judgement even once we get agreement, if we ever did, on what the connection test is, and still quite a reasonable amount of judgement, too?" he says, "Yes."

So, the reason I take you to that is because, really, what the experts were, what he was agreeing was that if it's the close connection test that was, that the High Court, Court of Appeal have endorsed, then the numbers became reasonably clear that Mr Cregten's were pretty much right and if it was his beneficial relationship test then his were pretty much right. So, there wasn't a lot of, lot in it once you got the test determined.

The next thing on my list, here, and I suppose the other adjunct to that is that, the, you know, it's really confirming that the test is workable once you get, if you know it's a close connection test, then the numbers, he agreed, came out pretty well right for Mr Cregten, so it was workable.

The next point on my list, which I think I can put a line through, is the reliance on the Australian code. My sense is that there's a view, which is certainly my submission to you, that it has not a lot to offer. The difference between unconscionability and the way in which this Act is set up, it really adds very little of value, other than the way in which it was considered and changed in the thinking that is revealed in those policy papers. So, I didn't intend to spent time on that unless anyone, any of Your Honours want time spent on it, and I'm not sensing that.

Then, the next issue which needs to be addressed is what I think has been referred to by my friend as other relevant factors which it is said the Courts below should have taken into account under section 41; in other words, factors other than the fee/cost relationship with the criticism of the High Court judgment in particular that His Honour did not take account, not take proper account of other relevant factors and, as a result, the numbers came out not right.

Now the first thing that's important to do here is just to note what was actually pleaded in relation to that and you will, as I think you know the third amended statement of claim in defence are in volume 1 of the case on appeal, which I think is – I say this because there's some issues being raised now that weren't pleaded. That's why I'm doing this. And that is at 106 of the case on appeal I think is where – page 106 is where I want to start Your Honours. This is in the statement of defence to the third amended statement of claim. It's the MTF statement of defence not the Sportzone one, but they mirror each other in this regard, so there's no need to take you to both.

So at page 106 you will see the first pleading, 106 at paragraph 42 you'll see the first of the pleadings of the reasons why it is said that the fee was not unreasonable, pointing to other matters other than the fee cost issue and the first is 42.2, no precise and unambiguous guidance available to creditors. Now this in relation to the establishment fee at this point but it's repeated with the account management fee and so on.

GLAZEBROOK J:
Is that from the Commission, that guidance?

MR MILLS QC:
Yes a Commission's guideline, well yes.

GLAZEBROOK J:
That's what I assumed, I just thought I'd –

MR MILLS QC:
That's what it turned out to be, a reference to the Commission's guidelines. The second ground relied on as being relevant under section 41 is the process MTF had used to set the fee. The third on at 42.4 is the fee charged by MTF's competitors and then the last one at 42.5 is reasonable standards of commercial practice. And Your Honours, just for completeness, will see that mirrored pleading effectively in relation to the other fees and the first of those is at page 110 and this is the account maintenance fee and it's just simply exactly the same except it's applied to account maintenance fees and then at 112 you will see the same again in relation to the prepossession fee and then finally at 115 you will see it in relation to the repossession fee, which as you know I think were the two limbs of the default fee, prepossession and repossession with different amounts for them. So that's what was pleaded as the other relevant factors.

Now there are – I think there's one matter being raised now which wasn't pleaded. I think it's been raised now under this head of other relevant factors and that's an overall reduction in profitability but that's not a pleaded other relevant factor and there's another one been raised about reduced interest margin and again that's not a pleaded matter.

Now I don't propose to spend time Your Honours on going through what's in the written submissions. My friend hasn't put any great weight on these other relevant factors, at least as I heard it in his oral submissions. It's in his written submissions but you'll see it in our written submissions beginning at paragraph 4.9 on page 18 which begins with this issue of lack of precise and unambiguous guidance and you'll see the Commission's response to that. Then the next one on the next page, amounts charged by MTF competitors, and on that the short point is that there was evidence that the Court was certainly entitled to accept, that there was uncertainty about that issue.

And then the next one has joined together the fee setting process and the reasonable standards of commercial practice down at 4.14 and again there was certainly evidence, including from Mr Smith who was called as an expert fact witness for the Commission, that what was being done here and the way in which MTF had put all of its fees, all of its costs into fees virtually, was not consistent with the reasonable standards of commercial practice.

So the short point which is developed in there was that the High Court was entitled to the conclusion it reached which was that there was nothing raised as a separate relevant factor under section 41 that warranted any different conclusion than the one that the Court came to.

Now I think the final thing that I have to deal to is at the back of my learned friend's submissions, as an annexure to it I think effectively. I'm sorry it's at the back of the outline that my learned friend handed up for oral submissions and unfortunately my friend said that he wouldn't deal with it unless I did and so I feel I do have to do something with this. I don't like the way he's smiling but at any rate I will have to say a few words about because they are claims that the Commission has made errors of facts in its submissions.

So the first point that is alleged that the Commission made an error with is this claim that MTF did not seek to recover all costs through its fees and it said that the Commission repeatedly suggested in its submissions that MTF sought to recover all of its costs through fees and adopted a full cost absorption model, this is incorrect. It's accepted and as I understand this is what the Commission had said, that MTF had adopted a full absorption model except the cost of funds and by that it meant

securitisation costs. So for what it's worth I think what the Commission has said about this is correct, that that is what the MTF position is as I've just recounted it.

Turning then to the next one that MTF profitable fell post the CCCFA and the references to paragraph 4.17 of the Commission's submissions it's said to suggest that in the period after MTF introduced the disputed fees its overall profitability increased, however the correct position is, as noted in paragraph 2.7 for MTF. MTF's profit from each dollar of income fell after it introduced the relevant fees. Now again I'm not sure it matters enough to actually go to Mr Cregten but perhaps I do need to but I'll just tell you what the position is from the Commission's point of view, that the MTF profit did increase over the period that we're dealing with 2007 through 2009 and perhaps to confirm that I should take you to volume 5 of the case on appeal.

All right. Okay, I can halt. My learned friend has, I suppose, kind of enabled this to be done more quickly. What that line I was going to take you from Mr Cregten shows is gross profit increasing and that's what the Commission was referring to. What my friend is saying, as I understand it, is that the profitability of MTF by reference to the capital invested in the business did not – the turnover of the business did not go up and so this is not a disagreement over a common fact, it's a difference of view about – it's different profit that's being referred to. So, again not an error in the Commission's submissions. Just different issues that were being looked at.

The final one, just skip through to the last page of my friends list of errors, is under the heading, "MTF did not discourage dealers from passing on interest rate cuts" and the statement from the Commission's submissions referred to an extract from an instruction to dealers under the heading "CCCFA what to expect." The full text was, "Buyer rate will convert to cost of funds based on current rates the buyer rate will drop from 9.35% to 7.75%. This is an instruction from MTF to its retailers. Do not drop your sell rate, the adjustment reflects in change in how fees will be charged."

Now what the Commission's position is on this is that as you can see from what's just been quoted there, that the buy rate for the funds dropped and the retailers, Sportzone for these purposes, was told "Don't drop your sell rate." What in fact happened, according to the evidence, was that some of the dealers did drop their sell rate further but the Commission's position is that MTF, as that extract is saying, had recommended against this and so if there was a drop in the rate that the retailers were charging, that was against the instruction of MTF or against the

recommendation, strong recommendation. And so there was a drop in the rate because it was preloaded by MTF but there was this further drop which was done by the retailers against the direct instructions of MTF. So the Commission again says what it had said about that is correct and doesn't accept that there was any criticism to be made of it for stating an erroneous position.

Now I think that covers all of the separate points that I wanted to deal with. Perhaps just really, so that it's left with a little bit of rounding off from the Commission's submissions, can I just take you to our written submissions beginning at page 6.8 and just read those through just briefly to close these off, it's only, less than a page or it's a little more than a page I see actually.

So at 6.8, the appellants claim that the judgments below will cause difficulties for borrowers who seek to challenge fees. The submission is unfounded for three reasons. First, the requirement for a Court to assess the cost fee connection is common ground. It will be required under whichever approach is adopted. Once it is accepted that sections 42 and 44 require a Court to assess a creditor's relevant and reasonable costs, the appellant's criticisms largely fall away.

Second, the appellant's interpretation of the CCCFA would be likely to make enforcement action by the Commission a little more than a means of keeping the industry fees within a broad band of comparability. It will not be easy for borrowers to identify relevant comparable creditors for the purpose of a fair market benchmarking exercise. It will be even more difficult for them to assess whether a creditor's cost is one that no reasonable lender would recover through a fee or based on costs which are wholly unrelated to a fee.

Third, the appellant's submission that every case would require a detailed cost assessment exercise and expert accounting evidence is not correct. Many cases will be brought by the Commission with its investigative powers and additional resources which will be better placed to monitor and enforce compliance. Moreover if a borrower challenges the reasonableness of a fee the evidential onus is likely to move to the lender to explain its costs and their relationship to the fee through which the costs are being recovered. In many cases where a lender has not taken steps to comply with the CCCFA, the creditor may be unable to call evidence to justify its fees. If the creditor does give evidence to justify its fee setting process when the fees were set of retrospectively when challenged by the Commission, it will be a

relatively simple matter to assess whether it is in compliance with the judgments below or whether, as in the case of the appellants in this proceeding, it has started from the incorrect premise of seeking to recover all operating costs through fees. Nor are there likely to be any undue difficulties in the Disputes Tribunal, a matter my friend has placed some weight on, which must consider the law but is not bound to strictly apply the law. The Tribunal will be far better placed to assess a simple cost assessment exercise limited to closely relevant costs used defensively by the lender, than it would be to assess a complex allocation of tenuous costs and industry benchmarking of the type undertaken by MTF in this case. And that's really, Your Honours, all I wanted to say, unless there's any further questions.

ELIAS CJ:
No thank you Mr Mills.

MR GODDARD QC:
Your Honour, I'm going to try to organise my I hope brief reply in a logical way rather than in a chronological way in terms of the way the issues emerged from my friend's submissions. I want to start by dealing with the scope of the concept of a credit fee. What is a credit fee and there was some questions from Justice O'Regan in particular about this. So if we look at the legislation under tab 1 of volume 1 of the authorities, page 11, "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." There's no limit in this definition on what the fee might be or relate to. It's deliberately broad and the reason it's deliberately broad is that if it's a credit fee it's subject to regulation under the Act. If it's not a credit fee, the section 41 reasonable test will not even bite, it will just be an unregulated charge. So the Act sets out to catch any fee charged under a contract that's not within the four exclusions over the page and in particular interest and certain other charges. Any other fee or charge, however described or even if it's not described, even if it's just, you know, a nominate fee, but provided for under a credit contract, will still be a credit fee and that's important because otherwise it's not within the net of the legislation and I don't think there will be any difference between the parties on that.

How does the definition go about ensuring not only its fee under the contract but also that avoidance measures like charging an advisory fee, a budget advisory fee or a club membership fee. We only lend to members, you have to join our borrowing club. Join our club and then we'll enter into a credit contract with you. How do they

do that? They do that by saying it includes fees in connection with a credit contract. So that concept of connection here is deliberately broadening things out. It's designed to say if it's under the contract or in any way connected with it, we're going to bring it into the net. So the language of in connection with here is deliberate broadening language and that's needed to make the regulatory scheme work.

If it's a fee of any of those kinds, with or without a name, even if it was just fee or as I said a nominate fee, then it's a credit fee, unless it puts it as a default fee or something else and then we turn to section 41 and the basic rule here is that a consumer credit contract must not provide for a credit fee or a default fee that is unreasonable and that is the starting point, necessarily the starting point of the enquiry. My friend said the main test is derived from sections 42 and 44. You go to those first and then you come back to 41. That's not right and the central argument of MTF is not, as my friend suggested, that you start with a market comparison then look to costs, it's that you start with the section 41 inquiry. You then go to whichever of 42, 43 or 44 informs that and then you come back to 41. So the way you do those other inquiries is shaped but that's important because a fee doesn't have to be anything other than fee or fixed fee in a contract to be a credit fee.

WILLIAM YOUNG J:
It might not be unreasonable in itself if it is not referable to something that is beneficial to the particular consumer.

MR GODDARD QC:
And that's the next point I wanted to come on to, which starts to come into the territory that Your Honour raised, is that what is beneficial to the consumer is the service of providing credit and when you think of what in the technical jargon is called multipart tariffs, you're talking about the different way you structure a price for an overall service, so for your mobile phone, for example, Your Honour, you can pay a purely variable price or you can pay a fixed monthly amount and then a variable price for each call.

WILLIAM YOUNG J:
But in the case where MTF borrowers – they really only got one package, didn't they?

MR GODDARD QC:
They got the provision of credit for the contracted period.

WILLIAM YOUNG J:

Yes, but in terms of the provision of credit, they got an interest rate and they paid all the time the same level of fees, establishment fees, account maintenance fees, and so on. Now, there might have been the odd variation but that's substantially correct, I think.

MR GODDARD QC:

Yes. The only qualification I'd suggest to that, Sir, is that if you come along and say, "I'd like to prepay," then that's obviously –

WILLIAM YOUNG J:

That's provided, of course, by section 43 and in the sense that's bespoke to the circumstances of that borrower.

MR GODDARD QC:

Yes. The question that was raised squarely by Your Honour's questions to my learned friend was does there have to be something over and above the plain vanilla service in order to trigger the charging of a fee? And in my submission that's not the scheme of the legislation.

WILLIAM YOUNG J:

Well, can I just put another proposition? If you look at section 42A and assume for the moment something you won't want to assume, and that is that the singular doesn't include the plural, you could read that as providing for fees that are referable to some cost enhancing characteristics of the transaction in issue.

MR GODDARD QC:

I think in the context of 42 that's not an unreasonable – that you've got individual costs and then you've got class costs.

WILLIAM YOUNG J:

And then secondly you've got under (b), you can say, well, if a particular class of transaction is defined by a common characteristic that's referable to the cost to the creditor providing the credit, then you can average those costs over the transactions within that class and charge a fee.

MR GODDARD QC:

I'm with you so far. It's the next step.

WILLIAM YOUNG J:

Just pause. I'm going to go backwards a minute and that might suggest that in (a) the transaction means what it says, that it means the transaction at hand, not all transactions because if it means all transactions there's not much need for (b), is there?

MR GODDARD QC:

The way that 42 is drafted, I think you're right. I think the distinction has been drawn between the singular and the collective.

WILLIAM YOUNG J:

Yes, but it's not a complete collective. It's a class of transactions. Now, you would say, "Well, as a matter of common sense that would include all transactions."

MR GODDARD QC:

I would, Sir.

WILLIAM YOUNG J:

Whereas I might be inclined to say that it rather presupposes that the charges will be referable to the cost of providing particular transactions which are more difficult to do than the run of transactions.

MR GODDARD QC:

And first it seems to me that there's no reason why the appropriate class can't be all your consumer borrowers.

WILLIAM YOUNG J:

Well, then, why not just say that at the outset?

MR GODDARD QC:

There are a lot of ways in which one might sit down and seek to redraft this, but the idea was that you can either look at the particular costs of an individual transaction if it's more or less idiosyncratic and charge that. You're not confined to averaging. But conversely, you can have a subset of customers. Your Honour is talking about a

bank. You've got credit card customers. That's clearly a class. So credit cards and you probably can segment that with the different types of card product, you know, premium cards and things like that but if you only provide one of those products, that doesn't mean that you're disentitled from charging the fixed fee element that the bank could charge that group because it's a subset.

WILLIAM YOUNG J:
I mean if you're wrong on that, then the Act is really simply to apply isn't it?

MR GODDARD QC:
If I'm wrong on that –

WILLIAM YOUNG J:
If the proposition I'm putting to you is right, that no question of reasonableness here arises because the Act doesn't contemplate the approach MTF has taken because it hasn't focussed on particular cost enhancing characteristics of either individual transactions or groups of transactions, then it makes this case easy. It would make other cases easy because normally by defining a class you'll define what it is – what the costs are.

MR GODDARD QC:
First that's the not case that MTF has had to meet at any stage of this proceeding and it would be very unfair to introduce that approach here without having –

WILLIAM YOUNG J:
Well we've got to construe the statute though.

MR GODDARD QC:
You do have to construe it Sir but second, the reason that MTF hasn't had to meet that case is that for good reason the Commission hasn't advanced it and that is that it would be peculiar if you could attribute fees to different classes that cause you different sets of costs to deal with but if you just have a narrower business and deal with one group, you can't spread it across the whole of that group. The existence of an exceptional class only arises if you're dealing with someone else with lower costs.

WILLIAM YOUNG J:

I mean you know far more about this than me but would it not provide for more transparent and differentiated pricing?

MR GODDARD QC:

No Your Honour because it would mean that to the extent that there are fixed costs associated with serving every customer you cannot recover those through a fee.

WILLIAM YOUNG J:

But that can be addressed most transparently in an interest rate.

MR GODDARD QC:

No Sir, if it's a fixed cost to deal with every customer. For example, a good example would be the cost –

GLAZEBROOK J:

Well but that would be very easily – if it applies to every customer because it's a fixed cost that applies equally to everyone, it would be much easier picked up in the interest rate than anything else and give comparable. That's all that's been put to you, whereas if it's a fee outside of that then comparability is more limited.

WILLIAM YOUNG J:

You see you could say well it's more expensive per loan to provide a one year loan than a three year loan. Okay fine, define that as a class of characteristics and put on a $50 establishment fee because we don't get the economies of scale with this loan and we'll get with a three year loan.

MR GODDARD QC:

In which case you would have – no one has – so what you're doing then Sir is defining the base case as your three year loan and saying there will no fees for three year loans and that's where the problem is, that whatever approach you took you could define some most cost effective class and then say for others the costs are different and you get into that. I don't think that you could make it work and no policy reason for preferring to recover flat costs that apply to a subset of customers but not flat costs that apply to all customers has been identified and more or less by definition that would mean that you had different regulation for different lenders, depending on the breadth of their business because what the base was would

depend on the universe of people you dealt with and then if you had some subset that was more expensive, you could add the extra on for them, whereas if you then have a borrower next door that only deals with the subset they couldn't charge any fixed fee at all. So far from improving transparency or comparability, you get a situation where the same product being offered to the same people, over here was being offered to a more expensive subset because they deal with (inaudible) there's a fee. Over here the subset is the only people you deal with and therefore there couldn't be a fee.

WILLIAM YOUNG J:
But you'd be reducing the level of fees overall, so you're reducing the level of obscurity in the pricing.

MR GODDARD QC:
Not if for the same potential borrower looking at different potential providers, you have one offering, a pure interest only, no fee product and the other offering a free business rate, you've got to do the comparison immediately. So that's an issue that you face every time that you choose between a tailored loan product like this and adding the money to your mortgage for example, which will not normally involve any additional documentation costs, especially if it's flexible. You will often be able to borrow purely by incurring additional interest cost or you can go to a targeted one. You have to do the comparison, there is no way around it and that gets back to the submission I made yesterday about the inherent complexity, the complexity being inherent in the range of products on the market today not being manufactured which means that you cannot enhance comparability by driving everyone into just interest rates and nor, importantly, do you enhance efficiency and of course market failure is not a black or white all or nothing issue. The basic policy setting here is that there are market failures, mostly to do with information as my friend said but the goal was still to let the market operate so far as possible while addressing the specific concerns in order to have diversity of products, efficient pricing. Your Honour's proposal wasn't the approach that was adopted and it wouldn't enhance comparability and as I said it's not how anyone has to date understood the Act is working.

WILLIAM YOUNG J:
We'll see.

MR GODDARD QC:
We will. That's why we're here.

ARNOLD J:
Well what I would certainly do is encourage any lender to develop appropriate classes within their client base.

MR GODDARD QC:
It certainly would Your Honour, you'd have a product for your 10 year borrowers and then you'd say oh for our five year borrowers or our three year borrowers where their loans are not in place for as long and we can't recover this sufficiently through the interest rate, so it's just going to distort the way things are done and it's going to disadvantage niche players in a way which seems, with respect, arbitrary. Not because it's necessarily better to be able to charge fees than interest rate, but because they would not have a choice about how to price that others would have and that comes back to my mobile phone example. There's no one right way to price mobile phone services. Different consumers have different preferences.

WILLIAM YOUNG J:
They're different services though aren't they?

MR GODDARD QC:
No Your Honour not necessarily.

WILLIAM YOUNG J:
Well they're offering different things to the subscribers whereas – I suppose what sort of sticks slightly in my craw is that basically it is leaving aside length of – the time for which credit is provided, it's a very homogeneous service.

MR GODDARD QC:
Well you might say the same of electricity and yet we pay a fixed fee for having access to the service and a variable fee for the energy that's delivered over the line. We're just getting power. It's a really boring homogeneous product but because part of the cost of providing it is fixed and part of it is variable, we see the charging reflect that and often with different options for different people. Indeed that's legally required now by the low volume charges but that's another matter.

So no restriction in the definition on what can be a credit fee. The substantive regulation of fees is in section 41. That's where the enquiry must begin. If the fee is an establishment fee, then you go to the factors that you're required to have regard to under 42. If it's another credit fee you go to 44.

WILLIAM YOUNG J:
Can I just ask you one other perhaps tendentious question?

MR GODDARD QC:
Of course Sir.

WILLIAM YOUNG J:
The freedom that you are seeking for finance companies is simply as to how they market the pricing of what they're offering.

MR GODDARD QC:
It's how they price what they're offering which will appeal to different borrowers depending on their circumstances and preferences. For example if I know I'm a very good credit risk, I may prefer to pay a flat fee up front and then a much lower interest rate. If I know I'm a good credit risk and I know I'm likely to have the loan on foot for that period, that will be a better deal for me.

WILLIAM YOUNG J:
Yes but these people, they're only offering one deal. I know that of course there are other people out in the market who are offering different deals.

MR GODDARD QC:
Yes there are and I was going to give the example of a creditor that offered different packages and to say that that's a good example of something which would also be relevant when it came to assessing reasonableness. So if you had a creditor offering two packages, one in, you know, all the charges packaged in the interest and the other an optional fixed fee and a lower rate, it seemed to me that when you came to assess the reasonableness of the fee, that would be a very good example of something other than cost that was relevant similarly and if that's right then immediately we can see that that sort of existence of options, existence of choices has to go into the mix when you assess reasonableness. Comparisons of the other products available must be part of the mix.

That choice illustration is perhaps the neatest illustration of something other than cost which obviously bears on reasonableness. The other one drops out of Your Honour, Justice O'Regan's question to be what seems like a long time ago now about having a fee of $10 where everyone else in the market's had 100 because you've done such clever innovation. You've come up with a very clever algorithm which at effectively no cost assesses creditworthiness much better than other people who manage to do it with more cumbersome processes. And these are not fanciful examples. That's exactly the sort of development that is happening.

That links back to Your Honour's question which is that the flexibility is partly in relation to the price structure and your ability to offer different price structures and experiment with what best serves your customer base, but it's also to do with the freedom to adopt completely different business models and price in a way which is reflective of the structure of that business model. It says that if you adopt a high capital cost, very low variable cost online model, where you almost have no people it's all done electronically, that doesn't necessarily remove your pricing flexibility compared with the situation of having some people doing it which would let you either recover, on the Commission's case, variable costs plus some fixed costs, or put it all into the interest fee. The idea that because you've done something clever and innovative, which reduces your variable costs, you've got less flexibility in how you price to attract different borrowers seems peculiar and wasn't part of the policy setting of this legislation as I think both the structure of the legislation itself and its antecedents reveal.

Just in terms of that question what is MTF's case? MTF's case is that you start with section 41 enquiry, is it unreasonable? You say well, there are one or two factors I'm directed to have regard to, if we're not talking about prepayment fees where there's a definition, and so you go to those and you ask those questions bearing in mind the ultimate purpose of the enquiry, which was an assessment of unreasonableness, and important information about what it means to talk in 42 about costs in connection with those matters is provided by the purpose of the enquiry, which is to assess unreasonableness. You ask well, what cost is it unreasonable to treat as connected with the matter? So the overall question informs this, and it's helpful to bear in mind that back in the definition of credit "in connection with" was used to broaden out the frame of reference.

So picking up Your Honour, the Chief Justice's question to my learned friend does it mean the same as of? In my submission it doesn't. It's deliberately broader. So it's not just the cost of doing those things. It's cost incurred in connection with it. So, for example, if I travel overseas regularly for work, as I do, I can buy travel insurance each time I travel. That could be described as a cost of the trip, certainly a cost in connection with the trip, even though I'm not actually paying for the travel. In fact, I travel so much it's more sensible for me to buy annual insurance policies. If I'm asked, did you incur the cost of your annual travel insurance policy in connection with this trip, the one I've just been on to The Hague, for example, my answer is, yes, and in connection with all the other trips I took in calendar year 2015. That cost, the cost of my travel insurance, is a cost incurred in connection with about four or five trips. So it's not just the cost of the trip, it's a cost in connection with it. Because it's incurred for that purpose there is an obvious connection.

If you ask, is it closely connected, for example, to the fourth trip, you might say, "Well, it was some time ago, I'm not so sure," you get a different answer if you ask the question that the Courts below asked. It was the wrong question. It's not the question in the statute and it produces wrong answers because it doesn't let something which is obviously a cost of those, in connection with those four trips be counted for any one.

It's also not an accident, I think, that we see that language "in connection with" there and the much tighter, plausible language of "arising from" in 43(1). Not only do we have definitional language "if and only if" in 43(1) in the second line, but then it goes on to talk about, "The creditors loss arising from the part prepayment including the creditor's average, reasonable administration costs arising from," so the language is different. It's not an accident. "In connection with" is meant to broaden our frame of reference. How broad? As broad as it's reasonable to go.

And then having conducted that enquiry we say, okay, we've looked at the costs that are connected. We come back to 41 because that's where the line is drawn again, picking up Your Honour, the Chief Justice's point. Where's the line drawn? The line's drawn in 41. Is it reasonably – okay, these are the connected costs of a particular transaction or of a class of transactions. If, as my friend said, there's nothing inherently unreasonable about the nature of the fee, if the costs that are incurred are reasonable costs and if they're connected with the matter, then that's likely to be the end of the enquiry. But if there's a gap, then I agree with my learned

friend that at least an evidential onus, and I don't think we need to be more precise at this stage, comes on the creditor to explain the gap.

What are the factors that you say make your fee reasonable despite the gap? And those factors may be that there was a choice of products and they chose this higher fee product as either from us or from a number of competing providers. It may be our fees are materially lower than other comparable providers. It would be odd to describe a low fee in the market as unreasonable when higher ones are reasonable just because they're less efficient. To say you can reasonably charge a high, less efficient fee but it's unreasonable if you're more efficient to charge a bit less but not a whole lot less is pretty rough. Not, I think, something one would normally describe as reasonable and all the other factors that is a matter of common sense go to what is a reasonable commercial practice in connection with charging fees? So you start at 41, you go to the other enquiry and you come back. That's the line.

What that means is that the approach adopted by the High Court really tacitly, because the High Court in its quantum judgment never looked at those other factors, and by the Court of Appeal explicitly in paragraph 58, to which Your Honour, Justice Arnold, took my friend, can't be right. The role of section 41 has been narrowed down almost to disappearing point in the Court of Appeal's analysis and it disappeared in the High Court. Those factors were not brought into play.

GLAZEBROOK J:
Well the factors you say have to be brought in because wasn't the – didn't the Court of Appeal or the High Court say there weren't any of these other factors that should be brought in for a start? The fees were about double given they were doubled up, so both Sportzone and MTF of anybody else in the market.

MR GODDARD QC:
No, the Courts below both said that the comparison wasn't relevant with other fees. My learned friend in his submission says they doubled up.

GLAZEBROOK J:
Well I'm not particularly – well, they were doubled up. There was Sportzone fees, two sets of establishment fees, two sets of administration fees. When you add those together, my understanding is they were about double of anything that was in the market, apart from an outlier –

MR GODDARD QC:
No, no that's –

GLAZEBROOK J:
When you're comparing, you're assuming that these people are actually setting their fees on a proper basis in the first place rather than plucking them from the air in any event, and I'm not sure, on your analysis, where you get the extra that might be there because you can have, on your analysis, the whole cost of business in any event.

MR GODDARD QC:
There were a lot of questions in there but let me deal with one which I think may be a misapprehension about the facts to start with. Your Honour's quite right that the effective establishment fee for a borrower from Sportzone is the total of the MTF fee of $190 and the Sportzone fee of $200. So that takes us to a figure of $390. If we go to volume 7 of the case on appeal and turn to page 1267, it's a summary, it's not the whole of the evidence on this.

ELIAS CJ:
Sorry I missed that reference.

MR GODDARD QC:
Sorry Your Honour volume 7 and it's a sort of ochre. I'm not sure, one has to be an interior decorator sometimes to do the colours and turn to page 1267. What Your Honour will see if we look at the fees in 2007 for example, because that's one in which we've got a lot of points of reference, is that if you add the 200 on to Motor Trade Finances' 190, so you have a total establishment fee of 390. Then going down the column, that's more than GE Money's but it's less than UDC for a vehicle loan, it's less than Marac Finance for a consumer contract, less than Mutual Credit Finance for a vehicle loan by a long way and about the same as Dorchester Finance. If we come through to 2012, where again because information was available, we have that range of products. You'll see that 390 falls pretty squarely within the middle of the range of establishment fees charged by people lending to purchase motor vehicles. So it's not the case Your Honour that it's double the comparable ones. It's right in the middle of the range, even when you take that into account.

Now there was debate among the witnesses about who the best comparators were but the fact remains that if you want to borrow to buy a vehicle this is a range of people in the market to whom you can go to borrow for your vehicle, these are the establishment fees you would pay and that meshes with the evidence of Mr Todd that as well as doing the figures in their model, they looked at the market to work out what a reasonable establishment fee was and that was how they got to their 190 and their recommended ceiling to their dealers of 200. So that was Your Honour's first point was the suggestion it was way above. As a matter of fact that's not the evidence.

GLAZEBROOK J:
It's way above a lot of them.

MR GODDARD QC:
Yes and way below others.

GLAZEBROOK J:
Well but so what?

MR GODDARD QC:
What that suggests is that at least as a first step there are other people who are either materially less efficient and actually incurring those costs or people who are charging too much. That takes you to the question and I absolutely accept that it's not intended as industry self-regulation that if everyone is charging too much then the comparison doesn't take you as far as it otherwise might but when you look at mainstream lenders like UDC and Marac and you see a fee that's in the same range.

GLAZEBROOK J:
I'm not sure that second tier lenders are necessarily mainstream lenders, are they, in that definition?

MR GODDARD QC:
We're not talking about the third tier lenders or the fringe finance people who the principal concern in the sector. Those are the ones that have the very high fees and there will be people outside this range again of course.

So that was one aspect of Your Honour's question was the comparison and that was an issue that was pleaded in my friend's terms and that was the subject of evidence

and that should have gone into the mix. Similarly the other factors in my 7.7, the restructuring. That again was pleaded, the process by which fees were set, which was that MTF didn't just put its fees up and hold its interest rate the same. MTF set out to rebalance the way it priced its service. It reduced its expected revenue from interest income by the same or it might have been slightly more I think than – well I think essentially the same as its expected projected increase in fee income. It wasn't aiming to make more money as a result of reallocating costs from interest to fees and it didn't achieve that holding the amount of loans constant. Because it grew its book it made more gross profit but its margin, its profit margin, for each $10,000 loan fell. I think we've ended up agreeing that that was the position. Of course, if you make more $10,000 you can grow your gross profit but the intended effect was that it net off, wasn't a grab for extra profits, and the outcome was, indeed, what was intended.

GLAZEBROOK J:
But the CCCFA isn't about regulating the amount overall that can be gained. So that is actually irrelevant on both sides isn't it?

MR GODDARD QC:
It's about the reasonableness of the fees and one factor that goes to reasonableness of fees is whether it was a good faith re-allocation of how you priced your expected revenue rather than incremental. To say I'm going to increase these fees and I'm going to sacrifice revenue over hear is, of itself, as a process for estimating future fees, intrinsically more reasonable than one that just says I'm going to put my fees up and hold interest rates constant and, therefore, go for higher income cream. This wasn't about cream. It was about pricing for the milk in what was seen as a more transparent and more efficient way, and MTF doesn't have to have been right. That it was more efficient, MTF just has to have been within the range of reasonable approaches.

GLAZEBROOK J:
But the reasonable approach was to allocate everything, according to you, and reasonable and acceptable, allocate everything but interest fund costs to fees.

MR GODDARD QC:
Again, I think we've ended up in agreement on what was and was not allocated. Of course the cost of funds, in terms of borrowing, interest rate paid on borrowed funds, wasn't included also as, I think, on common ground with my friend, in MTF's initial

allocation. There was no inclusion of the cost of accessing those funds, securitisation costs.

The other matter that I think is common ground, but I should just be explicit about because there's been a bit of confusion about cost of capital, is that MTF also did not in its initial allocation take into account the cost of capital associated with assets used for the purpose of its lending activities. So in its initial allocation it didn't take into account, for example, the ownership cost of its IT equipment. At the quantum hearing, what MTF said was well, if you're disallowing other things, then we think we can legitimately include this, so we'd like it taken into account.

GLAZEBROOK J:
When you say cost of capital, are you talking about cost of equity capital or cost of borrowing, because cost of equity capital is not an actual cost in accounting terms? Of course an economic cost.

MR GODDARD QC:
Yes. The cost of working capital, both equity and debt as I understand it, was not taken into account, as distinct from the cost of debt that was on lent.

GLAZEBROOK J:
That's what I –

MR GODDARD QC:
Yes, so both.

GLAZEBROOK J:
Both.

MR GODDARD QC:
Both equity and debt capital that was working capital was not taken into account, and my learned junior, who's very familiar with the exact numbers and nodding, so I've probably managed to get that bit of information right. And that's – and again, Your Honour's quite right, that we then get to the point that if you're borrowing to buy your computers, you're actually incurring an accounting cost. If you fund them out of shareholder equity, it's not an accounting cost but it would be an odd regulatory regime that said that whether or not you can charge a fee –

GLAZEBROOK J:

Well, but your position is that you can take all of that into account and actually you can take into account the setting up and securitisation. The only thing you can't allocate to fees reasonably is the actual interest costs that you pay to someone else on the funds that you're lending out. That's the position.

MR GODDARD QC:

If you have appropriately described fees, but I also accept that given the descriptions that were attached to MTF's fees, there will probably be some categories of cost that are not fairly described as connected to any one of those fees over and above the ones that weren't counted.

GLAZEBROOK J:

But you're saying the way that you interpret the legislation is you can allocate the whole cost of business provided you describe them properly, apart from interest costs and, what's more, if that gives you a figure that's lower than the market, you can actually add a bit more on and still not be unreasonable.

MR GODDARD QC:

It would all depend on how you describe the fee but if –

GLAZEBROOK J:

No, no. Assume you've described the fee to cover absolutely every possible aspect of the business, you can allocate everything and even so under 41, you can add a bit more to put yourself lower than the I don't know where, somewhere in the market.

MR GODDARD QC:

We're a long way from the facts of this case now but –

GLAZEBROOK J:

No, but you're asking us to interpret the legislation.

MR GODDARD QC:

Yes, absolutely, and – but it seems to me that in principle if you have a very low cost, highly automated, online borrower that can recover all of its costs of business through a fixed cost recovery fee and then charge a very low rate of interest, if it says

fixed cost recovery fee, interest rate, da, da, da, then, yes, in principle that would be right, and that if that fixed cost recover fee comes in at $30 a loan, which is less than anyone's charging for an establishment fee never mind anyone else, it would be surprising to conclude that that was an unreasonable fee. So, of course it all depends, my whole case is that it all depends, and that you look at all the facts relevant to each particular case.

But is that an inconceivable scenario? Is it inconceivable that a fixed fee that recovered all your very low operating costs would be reasonable? No it's not. But it would have to be a pretty special lender, creditor for that to work and it's not, as I say, the issue that – it's relevant to interpreting the legislation, I accept that. I've asked the Court to consider hypotheticals. It doesn't really lie in my mouth to decline to embark on the –

GLAZEBROOK J:

Well it's not really a hypothetical. I'm just saying that you say there's absolutely no limit, apart from a general everything in the pot reasonableness because, in fact, you can allocate all of your costs and you can even go above that on fees rather than interest.

MR GODDARD QC:

You have to have regard to costs and if there's a material gap between costs and what you're charging you're going to have some explaining to do.

GLAZEBROOK J:

But as your costs are a total cost recovery of everything except the cost of funds that you on lend, the direct costs of funds you on lend –

MR GODDARD QC:

And if that is in the context of that lending business and its target market and the overall quantum received a reasonable outcome then, yes, that's permissible. This is the point at which I don't know –

ELIAS CJ:

Yes I – well, that is as I'd understood your argument.

MR GODDARD QC:

Yes it is, Your Honour, but at the same time –

ELIAS CJ:

It’s part of the choice, you say is –

MR GODDARD QC:

The flexibility.

ELIAS CJ:

Yes.

MR GODDARD QC:

Which is designed to serve people better so you can have a one fee – no, you can pay it, you can have a buffet where you pay a fee and you eat as much as you can, or you can have an a la carte menu, or you can have an a la carte menu, or you can have a buffet but excluding dessert where you pay extra for dessert. We sell food in that way. We sell mobile phone services in that way and rightly or wrongly seen from 2015, the theory in 2003 was that credit should also be able to be sold in that way subject to the oppression regime in relation to overall terms and charges and subject to a reasonableness requirement in relation to fees.

Now I’ve fallen slightly into the trap, I think, of suggesting that reasonableness of what can be charged by way of fee and reasonableness of quantum will always be two separate enquiries. What Your Honour, Justice Glazebrook’s questions highlight very neatly is that actually they may run together, and that, I think, is where Your Honour, the Chief Justice, was headed.

I’m pretty much, as you’d hope, there I think. I should perhaps just mention that given Your Honour Justice Glazebrook’s tone of somewhere between surprise and scepticism in relation to those propositions about recovering all costs that this is in fact a view that the Commission itself held at one stage which in my submission illustrates that it is within the range of reasonable views available and I won't go to it now but in the Commission’s draft guidelines from 2009 which are in volume 9, beginning at page 1680, Your Honour will see at 1681 that one of the base concepts was a creditor should be able to recoup all prudently incurred costs through fees. So

that was seen as a reasonable approach consistent with the Act be reasonable people.

GLAZEBROOK J:
Well it depends what they meant by cost doesn’t it?

MR GODDARD QC:
And it goes on to look at cost of capital and things like that as well.

GLAZEBROOK J:
Well we’re interpreting the legislation. The Commerce Commission doesn’t tell us how to interpret the legislation.

MR GODDARD QC:
It certainly doesn’t.

ELIAS CJ:
Well that was covered in the written submissions both ways.

MR GODDARD QC:
It was. Now I’m just working out whether there’s anything that genuinely helpful that I should do. I should perhaps draw the Court’s attention, given the emphasis that my friend has put on variable costs assisting with comparability and the reference to Mr Small’s evidence, note that and again I won't go to it, that in cross-examination volume 6, page 952, Mr Small accepted that given the range of variable costs that one can see in the market, the comparability issue is not solved by limiting fees to variable costs. Borrowers still have to do a comparison between widely different pricing structures for different loans in order to work out which is the more appropriate product.

One more factual issue just in case it assists Your Honour Justice Young, talking about account maintenance being highly automated. Perhaps we’re flagging that that service of course also includes receiving calls from people asking if they can defer or restructure, receiving calls from people saying they’ve moved address, receiving calls from people saying they’ve changed employer and need to do a new – or changed bank and need to do a new AP, all those things. So there's a big call centre. Mr Todd gives evidence about it. There's quite a lot of real life human

interaction involved in the account maintenance fee as well. It would be wrong to think that this is just being charged for a computer to do something in the background. There are calls coming in, calls going out, the whole range of dealings with people in his evidence addressing that. The full process map is in Mr Cregten's evidence in fact, volume 5, page 804.

GLAZEBROOK J:

Sorry what is at volume 5?

MR GODDARD QC:

Volume 5, page 804, there's a process map which shows calls coming in and going out and all the things involved in account maintenance activities.

I think my friend ended up dealing fairly with the point that there's room for difference in views on cost allocation, whichever test you adopt. Neither brings with it a single point estimate, on either approach you're going to end up asking has this been done reasonably which means that really when we're choosing between the tests, there's no advantage in workability in terms of the Commission's test, rather the question is, is it mandated by the legislation, is it productive of strange and undesirable practical consequences, is it consistent with the policy of the legislation and because, in my submission, the Courts below misdirected themselves on the connection test by adding this closely rider which is a gloss that's not warranted by the statute, the appropriate test does need to be reapplied in the High Court and that's reinforced by the fact that other factors going to reasonableness which were established by the evidence also were not in fact taken into account as the Judge went through item by item. There was no stand back section 41 evaluation and the Court of Appeal erred in saying you don't get to that on this case. There was enough evidence of enough other factors that that stand back should have happened and in my submission for that reason the appeal should be allowed.

ELIAS CJ:

Stand back, how far do you have to stand back?

MR GODDARD QC:

You have to stand back and take into account the factors going to reasonableness that have been identified by the creditor and supported by evidence.

ELIAS CJ:
In respect of the fee identified.

MR GODDARD QC:
In respect of the fee identified.

GLAZEBROOK J:
So what do you say should have been taken into account?

MR GODDARD QC:
Relativity, well they're in my 7.7. Let me not try to paraphrase them. I just refer Your Honour to 7.7 of my full submissions. The process, the restructuring, any costs don't come within closely connected. If that leaves some costs out then the fact that there were costs is a relevant factor, the cross subsidisation that would result from lumping some of the costs disallowed by the Commission into an interest rate, comparison with fees charged by other creditors and the range of reasonable views that can be taken about how it's most appropriate to price a product of this kind in a market where a range of different structures are available and I've provided references to the evidential foundation for each of those. So two significant problems with what happened below and the quantum, incorrect approach to connection of costs which meant that some costs that were mandatory relevant considerations were disregarded and cent for cent as a result what was permitted by way of cost didn't flow through. Second, the stand back didn't happen, there was not that evaluation. Indeed the Court of Appeal explicitly rejected the need for such a stand back where you were ahead of your costs. That paragraph 58 that Your Honour Justice Arnold took my friend to which in my submission must just be wrong. Unless the Court has anything I can assist with, those are my reply submissions.

ELIAS CJ:
All right, thank you Mr Goddard, thank you counsel and thank you for a long day. We'll adjourn and we will reserve our decision.

COURT ADJOURNS:5.03 PM