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Introduction

[1] The first defendant (Bluestone) is a wholly owned subsidiary of an Australian company, Bluestone Group Pty Ltd, which specialises in residential mortgage lending. Its lending is attractive to borrowers who do not satisfy traditional lending criteria.

[2] Bluestone's customers include those with adverse credit records, immigrants, the elderly, and the unemployed, who may not have established financial records, and other groups who, for various reasons, may not be attractive to first tier lending institutions.

[3] Most of Bluestone's residential home loans are for 30 year terms. The relevant interest rates are higher than those which would apply to home loans to more conventional borrowers. The pattern displayed by Bluestone's borrowers, however, is that after two or three years of meeting their mortgage obligations, and thus building up a respectable credit record, they refinance from first tier lenders at lower interest rates.

[4] No mortgage lender can fetter or restrict a mortgagor's ability to repay early. For obvious commercial and financial reasons, mortgage documents usually provide for some form of additional fee or penalty sum to compensate the lender for repayment during the mortgage's term. The contractual mechanism adopted by Bluestone to meet early repayment of mortgages was called a deferred establishment fee (DEF), which is scrutinised later in this judgment.

[5] The Commerce Commission (the Commission), as plaintiff, formed the view that the DEF breached relevant provisions of the Credit Contracts and Consumer Finance Act 2003. It filed proceedings pursuant to its statutory powers seeking orders under s 94(1)(b) against Bluestone to pay compensatory sums to various borrowers.

[6] Bluestone (for all defendants) has adopted the bold approach of seeking summary judgment against the Commission and in the alternative an order striking

out the Commission's claim. At the core of Bluestone's submissions at this interlocutory phase is the claim the Commission's assessment is entirely misconceived and that there has been no breach of the Act.

Relevant statutory provisions

[7] The Credit Contracts and Consumer Finance Act 2003 is essentially consumer protection legislation. It provides an extensive statutory regime imposing a degree of control over financial lenders. The stated s 3(a) purpose is "to protect the interests of consumers in connection with credit contracts, consumer leases, and buy-back transactions of land". Of specific relevance to the parties' dispute is the s 3(b)(i) purpose:

To enable consumers to distinguish between competing credit arrangements or completing lease arrangements.

I accept the aphoristic submission made by Mr Mills QC that a clearly identified purpose of the Act is to enable an "apples for apples comparison" between competing offers for credit.

[8] Subpart 6 of the Act deals specifically with fees. Subpart 7 relates to payments and prepayments.

[9] Central to the Commission's proceeding are two types of fee; establishment fees and prepayment fees. Broadly speaking, the statutory policy is that such fees must be reasonable.

[10] Section 5, the interpretation section, defines establishment fees thus:

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

[11] There is no statutory definition of a prepayment fee. However, overarching all fees charged by lenders is the s 5 interpretation of "credit fees":

credit fees means fees or charges payable by the debtor under a credit contract, or payable by the debtor to, or for the benefit of, the creditor in connection with a credit contract (including any insurance premiums payable if the creditor requires the debtor to obtain insurance cover from a particular insurer); but does not include the following:

- (a) interest charges:
- (b) a charge for an optional service:
- (c) a default fee or a default interest charge:
- (d) government charges, duties, taxes, or levies

[12] The issue of unreasonableness, central to the Commission's case, is highlighted by s 41 which provides:

41 Unreasonable credit fee or default fee

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

[13] The Commission's amended statement of claim centres on Bluestone's DEF. Establishment fees, as defined by s 5, are the subject of s 42 which provides:

Establishment fees

In determining whether an establishment fee is unreasonable, the Court must have regard to—

- (a) whether the amount of the fee is equal to or less than the creditor's reasonable costs in connection with the application for credit, processing and considering that application, documenting the consumer credit contract, and advancing the credit; or
- (b) whether the amount of the fee is equal to or less than the creditor's average reasonable costs of the matters referred to in paragraph (a) for the appropriate class of consumer credit contract.

[14] Prepayment fees, in terms of the statute, are tied, in any assessment of their reasonableness, to the lender's loss which flows from early repayment.

43 Prepayment fees

(1) A fee or charge payable on a part prepayment under a consumer credit contract is unreasonable if, and only if, it exceeds a reasonable estimate of the creditor's loss arising from the part prepayment, including the creditor's average reasonable administration costs arising from part prepayments under consumer credit contracts of the appropriate class.

(2) A fee or charge payable on a full prepayment of a consumer credit contract (other than a fee relating to administrative costs) is unreasonable if, and only if, it exceeds a reasonable estimate of the creditor's loss arising from the full prepayment as calculated in accordance with section 54.

Subsection (2) seems to govern Bluestone's situation given the phenomenon of repayment by its lenders to which I have referred (*supra* [3]).

[15] The unreasonableness/reasonableness of a prepayment fee and a creditor's loss is linked, by s 43(2), to s 54 which provides:

54 Creditor's loss arising from full prepayment

(1) A creditor must calculate a reasonable estimate of its loss arising from a full prepayment using—

- (a) a procedure prescribed for the purposes of this section by regulations; or
- (b) an appropriate procedure set out in the consumer credit contract for calculating that loss.

(2) If a creditor uses a procedure prescribed for the purposes of this section by regulations, the amount calculated is to be treated in any court and in any proceedings under this Act as a reasonable estimate of the creditor's loss.

The regulations referred to are the Credit Contracts and Consumer Finance Regulations 2004.¹ However, to the extent that s 54 is relevant, Bluestone is relying on the procedure stipulated in its contract rather than the regulatory scheme.

[16] Section 51 deals with full prepayments (s 43 providing specifically for both part prepayments and full prepayments). It provides:

¹ SR 2004/240.

51 Amount required for full prepayment

(1) The amount required for the full prepayment of the consumer credit contract must be no more than the sum of the following less the amount referred to in section 52:

- (a) the unpaid balance at the time of the full prepayment; and
- (b) if expressly authorised by the contract, the administrative costs incurred by the creditor arising from the full prepayment or a charge equal to the creditor's average administrative costs arising from full prepayments of consumer credit contracts of the appropriate class; and
- (c) if expressly authorised by the contract, a fee or charge that does not exceed a reasonable estimate of the creditor's loss arising from the full prepayment.

(2) In calculating the unpaid balance, the creditor must only include interest charges and other fees and charges that have accrued or would ordinarily be payable under the consumer credit contract up to the time of the full prepayment.

The reference to s 52 concerns insurance rebates, - not an issue here.

[17] Finally, I include s 44, which again stipulates the unreasonableness of fees:

44 Other credit fees and default fee

(1) In determining whether a credit fee or a default fee is unreasonable, the court must have regard to,—

- (a) in relation to the matter giving rise to the fee, whether the fee reasonably compensates the creditor for the following:
 - (i) any cost incurred by the creditor (including the cost of providing a service to the debtor if the fee relates to the provision of a service):
 - (ii) a reasonable estimate of any loss incurred by the creditor as a result of the debtor's acts or omissions; and
- (b) reasonable standards of commercial practice.

(2) This section does not apply to—

- (a) establishment fees; or
- (b) a fee or charge payable on a part prepayment under a consumer credit contract; or
- (c) a fee or charge payable on a full prepayment of a consumer credit contract (unless the fee relates to administrative costs).

During the hearing I raised s 44 with Bluestone’s counsel, since I was interested in the possibility of Bluestone’s DEF being a hybrid fee, neither an establishment fee nor a full prepayment fee. However, Ms Cooper did not rely on this provision.

[18] I have mentioned the equitable and Property Law Act 2007 right of a mortgagor to redeem the mortgage sum at any stage. This right is expressly reserved by s 50. It is illegal for a consumer credit contract to prohibit full repayment (s 50(3)).

The deferred establishment fee

[19] A representative Bluestone agreement, to which frequent reference was made during the hearing, was one entered into in November 2005 by a Waitakere resident Mr A P Fraser-Jones who was the borrower. This loan agreement was exhibited to an affidavit of one of Bluestone’s deponents and its CEO, Mr PT McGuinness. The lender in this particular agreement was the third defendant. The first defendant was the “manager”. The loan amount was \$250,000. For the first three years there was to be a fixed monthly rate payable by the borrower of \$1,997.92. Thereafter an indicative annual interest rate of 9.59% would apply. The term of the mortgage was 30 years, with repayments to be made by 360 monthly payments.

[20] Stipulated fees and charges were:

- Completion fee \$ 990.00
- Switch/split administration fee \$ 400.00 per switch/split
(This fee applies if the borrower changed the mortgage account to another Bluestone product.)
- Valuation fees \$ 510.00
- Lender’s documentation costs \$ 640.50
- Brokerage fee \$1,250.00
- Discharge administration fee \$ 500.00 per discharge
(When paid in full.)
- Discharge documentation fee \$ 300.00 per discharge

[21] All these fees are contained in the loan document underneath the heading “credit fees and charges”. Under that heading appears a further bolded italicised heading “credit fees and charges that must be paid”.

[22] Next appears the DEF:

Deferred Establishment Fee

You have not been charged the full costs of setting up this loan. The amount you have not been charged is 4% of the **Total Loan Amount**. You may pay this establishment fee on the **Settlement Date** if you wish. However, if you do not pay it on the **Settlement Date**, the **Lender** will waive the whole of this fee if you keep the loan for 4 years or more. If you repay this loan in full during the first four years of the term you must pay the following establishment fee:

- if you repay during the first year of the term: 4%
- if you repay during the second year of the term: 3%
- if you repay during the third year of the term: 2%
- if you repay during the fourth year of the term: 1%

[23] The next stipulated fee appearing in the loan agreement is a “Fixed Rate Break Cost Fee”. I have included this fee because, although on its face it is payable if a borrower repays a fixed rate loan early, it appears that such an event might also trigger an obligation to pay other fees, including the DEF.

Fixed Rate Break Cost Fee

If and when the whole or any part of a fixed rate loan is repaid during its fixed rate term for any reason, including you repaying early, repayment because of a demand by us after default, switching to a different interest rate option (which you may only do with our consent), you must also pay the Fixed Rate Break Cost Fee. Note that in addition, you may be obliged to pay the Switch/Split Administration fee, the Discharge Administration Fee, the Discharge Documentation Fee and the Deferred Establishment Fee (see above).

The Fixed Rate Break Cost Fee is the amount which is the greater of:

- (a) the amount we have to pay any other person in relation to the termination of any contract we have entered to assist providing the fixed rate loan to you; and
- (b) an estimate of the loss which we will incur because we are no longer entitled to interest at a fixed rate on the amount repaid early. We will in good faith calculate the estimated loss as the discounted present value of the difference between:
 - (i) the yield we would have received on the amount repaid early; and

- (ii) the mid-market swap rate against 90 day bank bills for a period of time approximating the remainder of the fixed rate period.

Please note that we do not use the formula set out in the Credit Contracts and Consumer Finance Act Regulations 2004.

Any request for disclosure of the amount required for full prepayment on a specified date or the effect of part prepayment or your obligations must be made in writing to the **Lender** or **Bluestone Mortgages**.

[24] The loan document provides that liability for the DEF can be avoided if the “establishment fee” of 4% of the total loan is paid on settlement date. In Mr Fraser-Jones’s case the establishment fee would have been 4% of \$250,000, i.e. \$10,000.

[25] Mr Fraser-Jones did not pay the establishment fee. On settlement the sum paid to him was \$246,609.50. From the loan of \$250,000 had been deducted the completion fee, valuation fee, documentation costs, and brokerage fee.

[26] For the sake of completeness I record that also exhibited to Mr McGuinness’ affidavit was a public relations type document, with assorted smiling faces on its cover, entitled “Welcome to Bluestone” and subheaded “including our customer charter”. That document has a dedicated section on commissions and fees. Most of page 12 describes Bluestone’s DEF. It includes the following information:

- A DEF is typically charged if a loan is repaid within a defined period of time.
- The reason [for the DEF] is that lenders make a substantial economic investment in each new loan they write and rely on the loan running for a certain term to recover their investment and make a return.
- Depending on the product the DEF applies for periods between two and four years.
- The DEF scale is set out in the loan agreement.
- Bluestone’s loan products are not “bridging loans”. If [the lender expects to refinance the loan] within the period the DEF applies the lender should

“consider carefully whether the DEF is higher than the cost of alternative products available”.

[27] Perhaps to soften this last advice the section concludes that Bluestone’s variable rate products “are highly flexible with respect to paying off principal early” and then redrawing the funds later.

[28] Bluestone’s counsel submitted that the information contained in this publication really removes any doubt or ambiguity about the nature of the DEF. Borrowers were fully informed.

Securitisation and expert evidence

[29] Both parties, for the purpose of this summary judgment application, filed detailed evidence to which I have been referred. This includes evidence from Bluestone’s officers; evidence from staff of the Commission; and evidence from experts in the economic and financial fields. I see no need, given the result of these interlocutory applications, to summarise the evidence. I have, of course, considered its relevance in the context of counsel’s submissions. Two features of the evidence need comment.

[30] There are a number of different but linked entities involved in Bluestone’s loan processes. Neither the first defendant, Bluestone Mortgages NZ Ltd, nor the third defendant, TEA Custodians (Bluestone) Limited which was the lender to Mr Fraser-Jones (supra [19]), are stand alone lenders. Ms Cooper helpfully outlined the process in her submissions and presented various charts.

[31] Bluestone uses a securitisation structure for its lending. Inevitably there are financial risks attaching to securitisation, a technique which lay close to the heart of the 2008 sub-prime financial crisis. There is no suggestion, however, that sub-prime collapse factors have blighted Bluestone’s operation.

[32] Bluestone set up a Warehouse Trust (of which the second and third defendants were trustee and custodian trustee respectively). The Warehouse Trust

obtained bank finance offshore (in this case from Barclay's Bank plc) to provide interim funding for loans.

[33] Once the Trust had built up a respectable number of loans (usually in excess of \$100 million), relevant portfolios of loans would be securitised, with the Warehouse Trust transferring the package of loans to a note-funded trust or securitisation trust. Again the second and third defendants were trustees. Usually such on-sale of the security package took place within a year of loans being advanced.

[34] The securitisation trusts would then issue notes to wholesale investors. The proceeds of those note sales would be applied to purchase the securitised portfolios from the Warehouse Trust which in turn would repay the original lending bank.

[35] The interest, income, and repayments generated by the initial loans are used by the securitisation trusts to pay interest and capital to note holders. The notes rank in different degrees of priority. Bluestone itself held a significant portion of the junior ranking notes (arguably the more risky) as well as being the residual beneficiary of the securitisation trusts. Because of its lower priority, submitted counsel, Bluestone, on the evidence, remained exposed to any losses which might occur on loans after the securitisation process. Counsel stressed that the securitisation procedures did not alter the obligations of borrowers who would only have to make their obligated payments once.

[36] On the evidence, submitted Ms Cooper, Bluestone was a loss making entity. It is thus untenable to suggest, when considering the policy of the Act, that Bluestone and the fees it charged were gouging borrowers or generating excessive profits.

[37] The complexities of these securitisation arrangements and the shared connections (financial, legal, and beneficial) between the various financial institutions involved are important. There is force in Mr Mills QC's submission that the focus of the Act and its objectives is on a *particular* consumer and a *particular* creditor. It would be surprising if Mr Fraser-Jones, or any other borrower, had any

knowledge of the various interests created in a loan agreement by the securitisation process after monies had been advanced. Even more unlikely is it they would care. But clearly the securitisation process creates other interested parties and also incurs costs, which must inevitably reflect the connected poles of risk and reward on the axis of any loan agreement.

[38] The Act makes it clear that, so far as fees or charges levied on a consumer by a creditor are concerned, they must not be unreasonable. Bluestone's submission is that, across the entire lending process, including the combination of securitisation and the phenomenon of its 30 year loans being repaid within the first four years, this sector of its financial operations is unprofitable. There can thus be no question, submits Ms Cooper, that Bluestone's REFs are unreasonable.

[39] It would be a bold judge who was prepared, in a summary judgment context, to assess the financial complexities of lending in this sector and the attendant costs of securitisation and conclude that, for one particular consumer, the DEF stipulated in his or her loan was reasonable, without the need for further inquiry.

[40] Both parties have filed affidavit evidence from experts. The deponents include Mr J P Hickey, a consultant actuary in Sydney, Professor G Bowman, an Emeritus Professor of Finance at the University of Auckland, and (for the Commission) Dr T C Daghiesh, a senior lecturer at the Victoria University of Wellington. These experts have commented extensively on matters raised in the Commission's amended statement of claim; on the appropriateness of Bluestone's DEF; and, as the Evidence Act 2006 now entitles them to do, on the ultimate issue. But the opinion evidence of these experts has not been tested. Again, I consider it would be a bold judge who would resolve the issue of whether or not relevant provisions of the Act apply to Bluestone's DEF in a summary context and on the basis of opinion evidence.

The Commission's claims

[41] The Commission's amended statement of claim contains three causes of action, the second and third being alternative. They are:

- a) Bluestone's DEF was a full prepayment fee as envisaged by s 43(2).
As such it breached the statute because:
 - i) It was unreasonable in terms of s 41(1) because it exceeded a reasonable estimate of the creditor's loss as mandated by s 54(2).
 - ii) It infringed s 51(1)(c).
- b) The second and third alternative causes of action alleged the DEF was alternatively an establishment fee (s 42) or another credit fee (s 44), both of which failed to comply with the requirements of those relevant provisions.

In his submissions, Mr Mills QC relied first on the second alternative cause of action, demoting the first cause of action to an alternative argument.

[42] The Commission's claims must be assessed against the well known criteria for strike out and summary judgment applications.

Discussion

[43] Ms Cooper argued that Bluestone should be granted leave to bring a summary judgment application out of time. She further submitted, that, given the robust analysis required by summary judgment jurisprudence, it was clear the Commission's claims could not succeed and therefore summary judgment should be entered in the defendants' favour. With less vigour she submitted the Commission's claims should be struck out.

[44] Mr Mills QC submitted the summary judgment application was misconceived. He further submitted leave should not be given to the defendants in any event to bring their application out of time. He pointed out that the proceeding was of some importance, being the first time that issues under subpart 6 of Part 2 had

been before the Courts. Both the issues and the evidence were complex. The issues dividing the parties were not amenable to summary disposition.

[45] It is unnecessary to replicate counsel's competent and detailed submissions in full. A brief summary suffices.

Avanti

[46] Bluestone needs leave to make a summary judgment application. In terms of Rule 12.4(3) a summary judgment application must be made either at the time a statement of defence was served on the plaintiff, or later with leave. Here, Bluestone's first statement of defence was filed on 8 May 2009. Almost six months was to pass until the summary judgment and leave application was filed on 3 November 2009.

[47] The reason advanced by Bluestone for this delay was the arrival of Asher J's judgment, *Commerce Commission v Avanti Finance*.² Judgment in that case was delivered on 28 April 2009, but doubtless its publication in *New Zealand Business Law* cases would have been delayed.

[48] The Commerce Commission had charged Avanti under the Act alleging breaches of ss 51 and 54. The contract itself had stipulated a compensation formula, expressed in algebraic terms, to fix compensation for the financier in situations where there had been early full repayment. The Commission took the view (the prosecution, extending to 50 credit contracts each of which had been terminated by the debtor before the contracts' end date by full prepayment), that the formula did not involve a reasonable estimate of Avanti's loss.

[49] The charges against Avanti were dismissed in the District Court. The Commission brought an appeal by way of case stated to the High Court. The question for appeal was:

² *Commerce Commission v Avanti Finance* (2009) NZBLC 102, 662.

Was the defendant required for the purposes of ss 51 and 54 of the CCCF Act to calculate a reasonable estimate of its loss on the assumption that it will immediately lend the funds prepaid at the then prevailing interest rates even when it has excess lending capacity?

[50] One can see at a glance that the question before the High Court was qualitatively different from Bluestone's situation. The central issue before Asher J was essentially whether a creditor, who did not rely on the s 54(1)(a) "safe harbour" procedure prescribed by the Regulations (supra [15]), was entitled to invoke a contractual formula which might bear no relationship to the regulatory scheme. Before Asher J the Commission did not argue that a creditor must always use the safe harbour formula. It did, however, submit that an alternative process must operate in broadly the same way as the regulatory formula and incorporate various "fundamental principles" taken from the formula, including changes in prevailing interest rates, mitigation for lost profit through relending, allowing for reducing loan balances over the unexpired portion of the loan, and an allowance for the time value of money.

[51] Asher J dismissed the appeal. He also rejected the submission that an alternative contractual formula should depend, for its reasonableness, on any similarity with the safe harbour formula.

[52] Asher J stated at [30] that a court did not have to regard any particular factors when assessing what was a reasonable estimate of loss. It would have to bear in mind the consumer protection purpose of the Act. He considered the statutory words justified a loss calculation which did no more than provide some compensation for a creditor's anticipated loss, and was not unreasonable ([32]). He considered that the *Avanti* contractual formula fairly reflected common law factors relating to breach of contract. At [44] he observed the legislature had allowed a creditor to be compensated for losses flowing from early prepayment, the only benchmark being reasonableness. He also observed, at [45], that a reasonable estimate did not require a perfect estimate. A calculation of an exact loss in these situations was impossible.

[53] On becoming aware of *Avanti* Bluestone's solicitors wrote to the Commission and suggested it might want to reconsider its stance. The Commission was unmoved.

[54] I do not consider that *Avanti* represents the knockout blow which Bluestone contends. The factual situations clearly differ. *Avanti* had a prepayment compensation formula. Bluestone has no such formula, but instead deploys, over a four year period, a decreasing percentage of the loan sum. Bluestone's DEF clause (supra [22]) describes the fee which has not been charged at the outset as "the full cost of setting up this loan". The *Avanti* clause referred to full prepayment in compensating the creditor for "any loss resulting from the full prepayment.

[55] There is, in my judgment, nothing in *Avanti* which precludes the Commission from investigating the reasonableness or otherwise of the DEF.

[56] Additionally, there are a number of important issues (some of which cross over in whole or in part to other issues raised by counsel) relevant to this proceeding, which were *not* discussed in *Avanti*. These include:

- a) Whether an establishment fee, as envisaged by ss 5 and 42, can only be recovered as an establishment fee or whether it can instead be recovered via other fees to which subpart 6 extends.
- b) Whether costs and fees incurred by a creditor in post-loan transactions, such as through the securitisation process, can be recovered retrospectively as a subpart 6 credit fee.
- c) The type of costs which can legitimately be recovered by the different routes of ss 42, 43, and 44.
- d) What are legitimate costs which can be recovered via a s 43 prepayment fee? In particular (in Bluestone's situation) can costs, other than the stipulated establishment costs, be legitimately recovered by way of a prepayment fee?
- e) Whether Bluestone's securitisation arrangements excuse what might otherwise be Bluestone's duty to mitigate its loss by immediately relending a prepaid loan.

- f) The extent to which, if at all, variable rate loans and the fixed rate break cost fee might be compounding factors.

[57] Thus, there is nothing in *Avanti* which would by itself justify giving leave to Bluestone to bring a summary judgment application out of time. *Avanti's* arrival did not justify the delay. Nor does *Avanti*, for the reasons I have stated, assist Bluestone in obtaining a summary judgment. However, in deference to Ms Cooper's other carefully constructed arguments, I examine other issues.

The DEF is unquestionably a full prepayment fee and does not breach the Act, and in particular does not breach s 54(2).

[58] Counsel did not formulate her submissions as broadly as the subheading suggests. Nonetheless the subheading accurately encapsulates Ms Cooper's arguments as they relate to the Commission's first cause of action.

[59] The many points made by Ms Cooper were briefly as follows. She submitted the loan agreement fairly and clearly set out when the DEF was payable and, depending on when full prepayment was made, the amount of the fee. There could be no uncertainty or ambiguity surrounding the borrower's obligation on Bluestone's evidence. As mandated by *Avanti*, Bluestone's business structure had been factored into calculating the loss.

[60] The Fixed Rate Break Fee covered financier costs incurred as a result of breaking fixed rate swap contracts, but no other costs. The DEF was a separate cost. Bluestone's evidence in that regard had not been contested by Mr Daghiesh. Future profit margins were clearly affected adversely by prepayments of variable interest rate loans.

[61] Section 51(1)(b) expressly authorised administrative costs incurred by a creditor flowing from full repayment to be recovered. Such costs were a separate component from a creditor's loss authorised by s 51(1)(c). The Commissioner was wrongly confusing those two components which were clearly canvassed in Bluestone's affidavit evidence.

[62] Although Bluestone's securitisation procedures prevented it from re-lending prepaid funds, Bluestone's ability to issue new loans was unaffected by prepayments. Thus Bluestone's position was really the same as *Avanti's*. It had one loan less than it otherwise would have had. But unlike *Avanti*, Bluestone was not able to relend prepaid funds, so it had no obligation to mitigate.

[63] Importantly, on the basis of Professor Bowman's evidence, Bluestone under-recovered all its deferred establishment costs. The break even point was not achieved until the 94th month of every loan, just under eight years, by which stage, of course, virtually all the loans would have been repaid.

[64] It was misconceived to submit, as the Commissioner might, that the securitisation process did not legitimately affect Bluestone's loss. Bluestone retained a significant interest in all loans following securitisation (*supra* [35]) and remained exposed to the risk of loan defaults. These aspects were dealt with in the affidavits of Messrs McGuinness, Hickey, and Professor Bowman. There is nothing in the Act to justify an interpretation that a creditor's choice of a funding structure should make a difference to how prepayment losses should be calculated.

[65] To be unreasonable, a fee must clearly exceed a reasonable estimate of a creditor's loss. Such an assessment could never apply to Bluestone since, on the evidence, it always made a loss in respect of prepaid loans. It did not break even on loans on a cash flow basis until around 40 months and, taking into account (on the basis of Professor Bowman's evidence) economic recovery and the time value of money, Bluestone did not recover its deferred establishment costs until the 94th month.

[66] Regardless of what wording might have been used to describe the DEF in the loan agreements, the provisions which obliged a consumer to repay a stipulated percentage over the first four years of the loan led to no other conclusion but that the DEF was not an establishment fee. It was a full prepayment fee. If that argument was unacceptable, then the DEF could only be an "other" credit fee covered by s 44. There is no uncertainty as to what costs had been included in the computation of the DEF.

[67] Counsel submitted there was nothing in the DEF or the loan agreement which prevented consumers from comparing the advantages of a Bluestone loan with other available loans. Bluestone's customer charter (supra [26]) clearly warned about the potential costs of the DEF.

[68] There is nothing unfair or disadvantageous to consumers through them being required to pay securitisation costs or at least contribute towards those costs. Securitisation costs were only 0.38% of total establishment costs of 4.89% in any event.

[69] When referring to "establishment costs", in the DEF section of its loan agreements, Bluestone was using that term more broadly than the statutory definition. Bluestone's costs include broker commissions, securitisation costs, and operating costs associated with the original loans. There was no double counting.

[70] Finally Ms Cooper stressed that the Commission has issued a number of s 98 notices to Bluestone. Bluestone had complied with all. A vast amount of financial information had been given to the Commission which both justified the DEF and established that there was nothing unreasonable about the costs which the DEF was designed to recover.

The Commission's submissions

[71] In addition to his submissions already noted, that subpart 6 had never been tested in court before and that the facts of this proceeding were clearly distinguishable from *Avanti*, Mr Mills submitted that the current proceeding was very much a test case. Centre-stage were how the defined fees in subpart 6 operated; how they related to interest; and what constituted the various types of fees. In the context of fees, prevailing interest rates, and the industry, these issues were important. They should not be decided summarily.

[72] A number of issues were disputed, including the opinions of the experts, thus placing them outside the summary judgment context. The expert witnesses were not fully engaged and were working on different assumptions. There was clearly a

dispute between the parties as to how establishment fees might be recovered. The assertion of Professor Bowman that establishment fees were never recovered until the 94th month was both problematic and unconvincing.

[73] The appropriateness of Bluestone's DEF to compensate lost profit needed scrutiny. On the issue of reasonableness, it is clear from its own evidence that Bluestone knew that most, if not all, of its 30 year loans were repaid by the end of the fourth year. A loss of profit was thus inevitable. Its proclaimed losses must be based on a false premise. The assertions by Bluestone's witnesses that its costs across the board exceeded the DEF beg the question of what costs were relevant.

[74] It is important for consumers to be able to compare both interest rates and establishment fees. The DEF was stated to be an establishment fee and unequivocally referred to the full costs of setting up the loan being deferred. Yet the structure of the DEF suggested it was no such thing. Assessing whether or not establishment fees and full prepayment fees were unreasonable required a consideration of different factors. Furthermore, on the face of the contract, various items (supra [20]) which were normally caught by the definition of an establishment fee appeared to have been deducted at the outset of the loan. These matters in combination infringed the s 3(b)(i) purpose (supra [7]).

[75] The Commission's primary submission was that the DEF, as described in the loan agreements, was precisely expressed as an establishment fee. The s 5 definition of an establishment fee did not require such a fee to be charged at any particular time. Contractually the loan agreements deferred payment of the establishment fee. Deferral did not change its nature. Yet Bluestone's evidence was, despite the clear nomenclature in the contract, the DEF was not an establishment fee because it factored in costs unrelated to setting up the loan.

[76] Counsel referred to some of the pre-legislative materials, including the briefing paper of the Commerce Select Committee, which discuss the concept of establishment fees being unreasonable if they exceeded the actual costs of setting up a credit contract and the need to prevent the undesirable practice of loading interest into an establishment fee.

[77] Mr Mills submitted strongly that the DEF was not a prepayment fee. He referred to clause 5.5 of the loan agreements (headed “payment of deferred establishment fee”) which provides that if the debt is repaid at any time during which the DEF is payable, the amount required to repay the debt must include the DEF. Counsel’s submission is this contractual provision was clearly captured by s 51(1)(a) but not by s 51(1)(c).

[78] As I have stated, both counsel advanced other submissions which I do not consider necessary to canvass.

Approach to summary judgment

[79] There is no dispute between counsel over the relevant approach, assuming that leave is granted to Bluestone.

[80] The application by Bluestone is against a plaintiff and is thus covered by Rule 12.2(2).

[81] It is clear law that a court will not hesitate to decide matters of law on a summary judgment application.³ Disputed factual (and by analogy legal issues) need to be approached robustly to ensure that hypothetical possibilities and vague, imprecise, or equivocal issues, which may be inconsistent with documents and statements, do not present unnecessary obstacles to a summary judgment.⁴

[82] In general terms (leaving aside the leave application), Bluestone would be entitled to summary judgment if it could show that the Commission’s causes of action would inevitably fail.

³ *Pemberton v Chappell* [1987] 1 NZLR 1 (CA).

⁴ *Eng Mee Yong v Letchumanan* [1980] AC 331, 341 (PC) per Lord Diplock; *Attorney General v Rakiura Holdings Ltd* (1986) 1 PRNZ 12, 14 (HC).

Decision

[83] Despite Ms Cooper's well structured and comprehensive submissions I do not consider that Bluestone has come close to crossing the threshold of obtaining summary judgment against the Commission.

[84] A few reasons for this conclusion, rather than an exhaustive catalogue, will suffice. My reasons include:

- That the loan agreement triggers contractually a borrower's obligation to pay the DEF only if the loan amount is repaid within four years (the amount of the DEF reducing annually but tied as a percentage to the original loan), does not necessarily lead to the conclusion that the DEF is *not* an establishment fee.
- A scrutiny of the fee's reasonableness is thus justified, particularly its relationship to actual establishment costs.
- In consumer protection legislation, and in particular given the purposes of the Act, it is intrinsically unsatisfactory for what could well be a prepayment fee to masquerade as an establishment fee.
- Although probably rarely exercised, contractual liability for the DEF could be avoided by a borrower paying the fee at the 4% rate at the outset of the loan. Arguably this protection could be misleading if in fact the protection was not from liability for "the full costs of setting up this loan" but rather for loss of the creditor's profit were there to be early repayment.
- A number of traditional establishment costs, such as brokerage fees, valuation fees, and administration costs, have already been deducted at the outset of the loan. It is thus problematic what extra establishment costs were to be covered by the DEF.

- If, as a matter of contractual construction, the DEF were to be regarded as a prepayment fee and not an establishment fee, then the entire issue of whether the prescribed figures (4% of the principal reducing to 1% over a four year period) comply with the provisions of s 54(1)(b) needs scrutiny, it being common ground the safe harbour alternative of the Regulations is inapplicable.
- I consider it is arguable (partly as a matter of contractual interpretation and partly as a matter of evidence) whether the DEF falls inside s 51(1)(c).
- The evidence produced by Bluestone might go a long way, or even the whole way, towards satisfying a court that the DEF, if it is a full prepayment fee, meets the reasonableness obligation imposed by s 43(2). But such an issue cannot be decided in a summary fashion, particularly when the parties' experts have not engaged, and further where there are issues as to the extent to which securitisation costs and arrangements might impact on the quantum of any loss Bluestone sustains.
- It is arguable the extent to which the real costs of securitisation, whatever they may be and however they may be borne between the linked parties to securitisation, should properly be charged (in whole or in part) to a consumer in the form of either an establishment fee or a prepayment fee.

[85] There may well be other issues equally unamenable to summary judgments. But the above list suffices.

[86] Furthermore, as a matter of policy, if the Court is assured by senior counsel that there have been no previous proceedings of this nature involving subpart 6 and that the proceeding and the issues it throws up are in the nature of a test case, then great caution should be exercised before disposing of such a proceeding in a summary fashion. There is excellent authority that caution should be exercised

before destroying, through the summary judgment procedure, a proceeding which might in fact assist in developing the law. (See *Westpac Banking Corporation v M M Kembla NZ Ltd*;⁵ *Couch v Attorney-General*.⁶)

[87] Given the view I have reached on the summary judgment issue, added to which is the *Avanti* issue (supra [57]), I decline leave in any event under Rule 12.4(3).

[88] A strike out application must fail where a summary judgment application fails. In any event, in the light of the standard approach with strike out applications, which is to assess whether a claim would fail on the assumption that the alleged facts were proved, the Commission's amended statement of claim comes nowhere near that threshold. The allegations point to fees stipulated in the contract; fees specified in statute; and assert the fees concerned are unreasonable. It cannot seriously be contended that if the Commission makes out those claims that the remedies it seeks might not follow. Ms Cooper did not attempt to argue to the contrary.

Result

[89] For the reasons apparent in the previous sections of this judgment the following results flow.

[90] The defendants' application to strike out the plaintiff's amended statement of claim is refused.

[91] The defendants' application under 12.4(3) is refused.

[92] In the event of my having granted leave under Rule 12.4(3), the defendants' application for summary judgment against the plaintiff would be refused.

[93] The pending applications (not argued before me by agreement between the parties) seeking further particulars and possible consideration of limitation issues,

⁵ *Westpac Banking Corporation v M M Kembla NZ Ltd* [2001] 2 NZLR 298 (CA) at [62].

⁶ *Couch v Attorney-General* [2008] 3 NZLR 725 (SC) at [33].

are adjourned. Inadequate time was allocated to consider these issues. Counsel should seek a further fixture if the defendants' pending applications are to be pursued.

[94] The Registry is directed to convene a short telephone conference before a Judge or Associate Judge as soon as possible so that timetable orders and directions can be made to bring the application on for hearing.

Costs

[95] Given the result, the plaintiff is clearly entitled to costs. However, counsel have agreed that, regardless of the result, costs should be reserved. I suspect the parties may wish to leave costs on these interlocutory applications unresolved until such time as either an overall resolution is negotiated or the substantive proceeding is determined. That is a sensible approach.

Additional comment

[96] I compliment both counsel on the high quality of their submissions and the considerable assistance they gave the Court. The hearing, raising as it did complex issues, was interesting and absorbing, for which counsel can take full credit.

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Priestley J