

In the High Court of New Zealand
Auckland Registry
Commercial List

CIV-2016-

Under Section 100A Commerce Act 1986

In the matter of a case stated by the Commerce Commission relating to the
Harmony Limited lending transaction and ss 5, 6 and 7 of the
Credit Contracts and Consumer Finance Act 2003.

Between **Commerce Commission** a body corporate established under
section 8 of the Commerce Act 1986 having its offices at level 6, 44-
52 The Terrace, Wellington.

Applicant

And **Harmony Limited** a company having its registered office at
Level 1, 308 Parnell Road, Auckland.

Respondent

Case stated for the opinion of the court

26 August 2016

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Case stated for the opinion of the court

May it please the Court:

1 Introduction

- 1.1 The Commerce Commission (the **Commission**) respectfully requests the opinion of the Court under s 100A of the Commerce Act 1986 on the applicability of the Credit Contracts and Consumer Finance Act 2003 (**CCCFA** or the **Act**) to a 'peer-to-peer' (**P2P**) lending transaction facilitated by Harmony Limited (**Harmony**) and Harmony Investor Trustee Limited (**the Trustee**). This transaction is referred to in this case stated as the 'Lending Transaction'.
- 1.2 Harmony commenced business in September 2014 pursuant to a licence from the Financial Markets Authority (**FMA**) issued under the Financial Markets Conduct Regulations (**FMCA**) 2014. Since commencing business, Harmony has charged fees to investors and borrowers in relation to all loans obtained through the service – including a fee referred to as the 'Platform Fee'. The opinion sought from the Court relates principally to whether the Platform Fee is a "credit fee" within the meaning of the CCCFA.
- 1.3 If the Platform Fee is deemed to be a 'credit fee' for the purposes of the CCCFA, then the Act requires that the fee must not be unreasonable. The recent decision of the Supreme Court in *Sportzone Motorcycles*¹ provides guidance in determining whether credit fees are unreasonable.
- 1.4 The questions submitted for the opinion of the Court in this case stated are not related to whether any fee is unreasonable, but are instead directed to the first stage of the analysis, namely to the question of whether or not the Platform Fee comes within the statutory definition of a credit fee.
- 1.5 From when it commenced business until December 2015 Harmony charged a Platform Fee based on a percentage of the Loan Amount. Harmony has since changed the manner in which it calculates the Platform Fee; apart from that change, the Commission understands that the Lending Transaction remains fundamentally the same. While the case stated relates primarily to the original Platform Fee regime, the Court's answers will apply to any fee structures which are similarly constituted.
- 1.6 The questions submitted for the opinion of the Court have been cast specifically in terms of the structure of the Lending Transaction. The Commission anticipates, however, that in reaching a view on the issues raised by each question, the Court will be able to provide judicial guidance on the underlying principles of law. The Commission would be greatly assisted by the Court's guidance on the correct application of those principles, particularly as they relate to the effect of the CCCFA on the nascent P2P lending industry.

¹ *Sportzone Motorcycles Ltd (in liquidation) and Motor Trade Finances Ltd v Commerce Commission* [2016] NZSC 53.

- 1.7 A concise summary of the facts necessary for the determination of the questions is attached as **Schedule 1** and the key documents relating to the Lending Transaction are annexed to that Schedule.
- 1.8 The Commission has provided a copy of Schedule 1 to Harmony. Harmony has also contributed to part five of this case stated, which sets out the Commission's and Harmony's positions regarding the questions on which the Court's opinion is sought.

2 The key documents

- 2.1 Until December 2015, the Lending Transaction was set out in five key documents, namely:
- (a) a document containing terms as between the investor, Harmony and the Trustee (referred to as the "**Investor Agreement**");²
 - (b) a document containing terms as between the borrower, Harmony and the Trustee (referred to as the "**Borrower Agreement**");³
 - (c) a document containing terms as between the borrower, Harmony and the Trustee (referred to as the "**Loan Contract**");⁴
 - (d) a document relating to a specific loan advanced to a borrower (referred to as the "**Loan Disclosure**");⁵ and
 - (e) a document containing terms as between Harmony and the Trustee which sets out the nature of their relationship (referred to as the "**Administration Deed**").⁶
- (collectively referred to as **the Documents**).
- 2.2 The Loan Disclosure and the Administration Deed were each amended while in force, prior to December 2015. Accordingly, both the initial and the amended versions of these documents are annexed to this case stated.
- 2.3 The Commission considers, respectfully, that the answers to the questions in this case stated will depend upon the Court's view as to the effect of the Documents.

² Investor Agreement as in effect 24 July 2015 to 9 June 2016

³ Borrower Agreement, as in effect 24 July 2015 to 7 December 2015.

⁴ Loan Contract as in effect 3 June 2015 to 7 December 2015.

⁵ Samples of which, including the initial version (dated 3 September 2014) and the amended version (dated 11 November 2015) are annexed to this case stated.

⁶ Administration Deed, including the initial version (as at 17 September 2015) and the amended version (in effect 29 October 2015 to date).

3 Questions for the opinion of the Court

3.1 The Commission respectfully requests the Court's opinion on the following questions:

(a) *Question 1*

Is the "credit contract", as defined in s 7 of the CCCFA, comprised of a number of the Documents operating together, or just the Loan Contract?

(b) *Question 2*

Is there a transaction that is in substance or effect a "credit contract" within the meaning of s 7(2) of the CCCFA?

(c) *Question 3*

Which entity or entities are the "creditor(s)" for the purposes of the CCCFA, as defined in s 5 of the CCCFA?

(d) *Question 4*

Is the Harmony Platform Fee a "credit fee" as defined in s 5 of the CCCFA?

(e) *Question 5*

Is the Harmony Platform Fee an "establishment fee" as defined in s 5 of the CCCFA?

4 Possible changes to the Lending Transaction

4.1 Harmony has indicated to the Commission that it has been developing a proposal for a revised transaction structure. At the time of filing, Harmony has indicated to the Commission that it has not finalised the details of its proposed new structure.

4.2 The Commission anticipates that Harmony's proposed new structure may also give rise to questions regarding the applicability and effect of the CCCFA. If that is the case, and the details are finalised in the near future, the Commission may seek the Court's leave to add further questions in relation to that proposed structure.

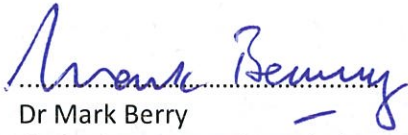
5 The contending positions on the questions

Question	Commission's position	Harmony's position
<p>Question 1 Is the "credit contract", as defined in s 7 of the CCCFA, comprised of a number of the Documents operating together, or just the Loan Contract?</p>	The credit contract is comprised of the Borrower Agreement, the Loan Contract and the Loan Disclosure together.	The Loan Contract is the credit contract.
<p>Question 2 Is there a transaction that is in substance or effect a "credit contract" within the meaning of s 7(2) of the CCCFA?</p>	Yes.	No.
<p>Question 3 Which entity or entities are the "creditor(s)" for the purposes of the CCCFA, as defined in s 5 of the CCCFA?</p>	Both Harmony and the Trustee are creditors for the purposes of the CCCFA.	The Trustee is the creditor as bare trustee for the investors.
<p>Question 4 Is the Harmony Platform Fee a "credit fee" as defined in s 5 of the CCCFA?</p>	Yes.	No.
<p>Question 5 Is the Harmony Platform Fee an "establishment fee" as defined in s 5 of the CCCFA?</p>	Yes.	No.

6 Process

- 6.1 The Commission intends to file substantive submissions setting out the basis for its proposed responses to the submitted questions, as summarised in part five above, in accordance with timetable orders which the Court will be asked to make by way of a separate case management memorandum.

Date: 26 August 2016


Dr Mark Berry

Chair, Commerce Commission

This case stated is filed by Alysha McClintock, solicitor for the Commerce Commission. The address for service of the Commerce Commission is at the offices of Meredith Connell, level 5, 4 Graham Street, Auckland.

Documents for service on the Commerce Commission may be:

- (a) emailed to james.cairney@mc.co.nz (solicitors Meredith Connell); or
- (b) if email is not practical:
 - (i) posted to Meredith Connell (attn. James Cairney) at PO Box 90750, Victoria Street West, Auckland 1142; or
 - (ii) left at the solicitor's address as noted above (attn. James Cairney).

Schedule 1 – relevant facts

Peer-to-peer lending

- 1 Peer-to-peer (**P2P**) lending allows private borrowers to obtain loans from funds advanced by investors. Platform providers typically act as the intermediaries between investors and borrowers, and contract with each.
- 2 P2P lending services typically provide an on-line lending marketplace where borrowers may request funding and lenders can choose to invest in any particular loan. Borrowers complete a loan application process in order that they may be identified and credit assessed. Borrowers and investors both remain anonymous to each other on the platform.
- 3 Providers of P2P lending services differ in terms of the risk profile of the borrowers they approve, the fees charged to borrowers and investors, and the degree to which they administer loans (including by undertaking collection services or by pursuing enforcement action).
- 4 The Financial Markets Conduct Act allows for the approval or prescribed intermediary services, including P2P lending services. The Financial Markets Authority (**FMA**) holds responsibility for licensing particular P2P lending services. To date, five providers have been licensed by the FMA to provide P2P lending services.⁷

Harmoney

- 5 Harmoney was incorporated on 15 May 2014 and is a wholly owned subsidiary of Harmoney Corp Limited.
- 6 Harmoney Corp Limited holds a licence from the FMA which authorises Harmoney to operate a P2P lending platform. Harmoney Corp Limited was the first company to obtain such a licence and Harmoney is currently the market leader in providing P2P lending services in New Zealand.

The Trustee

- 7 The Trustee was incorporated on 9 July 2014 and is a wholly owned subsidiary of Harmoney Corp Limited.

The Lending Transaction

- 8 As set out above, the Lending Transaction is set out in five key documents (each of which are **annexed** to this schedule, and referred to as “the Documents” in the case stated), namely:
 - (a) a document containing terms as between the investor, Harmoney and the Trustee (referred to as the “**Investor Agreement**”);
 - (b) a document containing terms as between the borrower, Harmoney and the Trustee (referred to as the “**Borrower Agreement**”);

⁷ Harmoney Corp Limited, Lendme Limited, Squirrel Money Limited, Lending Crowd Limited and PledgeMe Limited.

- (c) a document containing terms as between the borrower, Harmony and the Trustee (referred to as the “**Loan Contract**”);
- (d) a document relating to a particular loan advanced to a borrower (referred to as the “**Loan Disclosure**”);
- (e) a document containing terms as between Harmony and the Trustee setting out the nature of their relationship (referred to as the “**Administration Deed**”).

9 This summary refers to the terms of the Documents, however the meaning of the Documents is not agreed between the parties and will be a matter for the Court. Similarly, in answering the questions, the Court will respectfully be asked to consider whether or not Harmony acts as an agent in performing any or all of its specific roles or functions.

10 The key elements of the Lending Transaction were:

- (a) Prior to any Lending Transaction, a prospective borrower was first required to register with Harmony.⁸ Harmony would then receive, consider and approve applications for registration in accordance with its eligibility criteria. Harmony performed various tasks including receiving and assessing loan applications and undertaking credit checks.
- (b) If the borrower wanted to take out a loan, he or she was required to complete a loan application.⁹ The loan application process was designed to assess a borrower’s credit grade, which in turn was used to determine the applicable interest rate and the maximum Loan Amount. The borrower then selected an agreed Loan Amount (between the maximum and a minimum of at least \$1,000) and chose whether to repay the loan over a 36 or 60 month term (provided that the borrower could afford to make repayments over a 36 month term).
- (c) Once a loan entered the online marketplace, investors decided whether or not to fund the Loan through placing an order.¹⁰ Investors made orders in \$25 increments – referred to as “notes” - for each investment until the loan was fully funded.¹¹
- (d) Investors paid the amount they wanted to invest in to an ‘investor account’. Harmony held the investor account in trust for investors whose funds had been deposited into that account.¹²
- (e) Once there were sufficient orders to fully fund the loan listing (or to offer funding of a lesser amount which the borrower nonetheless agreed to accept), Harmony transferred the investor funds from the investor account to an ‘advance account’, a separate bank account held by the Trustee on trust for investors.¹³

⁸ Borrower Agreement clause 5.

⁹ Borrower Agreement clause 12.

¹⁰ Investor Agreement, clause 12(b).

¹¹ Investor Agreement, clause 12(b).

¹² Investor Agreement, clause 12(a).

¹³ Investor Agreement, clause 12(b).

- (f) Harmony would then transfer the loan principal into the borrower's nominated account.¹⁴ The borrower did not sign a Loan Contract, as the contract was stated to come into existence immediately after Harmony provided a Loan Disclosure.¹⁵ From that point, the Trustee held the loan on trust for the benefit of investors.¹⁶
- (g) Settlement of a loan would occur within one business day after Harmony provided the Loan Disclosure.¹⁷ At Settlement, Harmony would deduct from the Loan Amount an amount equal to the Platform Fee (outlined below) and transfer it to Harmony's own account. Harmony would pay the balance of the Loan Amount to the borrower's nominated account.¹⁸ The Documents state that these fund transfers were to be made by Harmony "at the direction of the Trustee, as authorised by the Borrower".¹⁹
- (h) The Platform Fee is defined in the Borrower Agreement as "the fee payable by the borrower to Harmony for arranging any Loan which settles, as set out on the Website under the "Interest Rates and Fees Section."²⁰ The Borrower Agreement defined the 'Loan' as "the total amount lent or to be lent by the Trustee" to the borrower.
- (i) Following settlement, the borrower had an obligation to make all of the loan repayments specified in the Loan Disclosure²¹ to a 'Collections Account' held in the name of the Trustee as trustee for investors.²² Interest accrued on the whole of the Loan Amount, which included the Platform Fee.
- (j) Harmony administered the loan accounts, including by receiving payments and undertaking recovery action. The Documents state Harmony did this as agent for the Trustee. Harmony charged a fixed service fee to investors for these services.²³ As at December 2015, this fee was set at 1.25 per cent of the principal and interest payments collected on funds advanced by that investor.²⁴

The advance of a loan to a borrower

- 11 To illustrate, the Lending Transaction was structured so that funds moved from the investor through to the borrower as follows:

¹⁴ Investor Agreement, clause 14(a)(i).

¹⁵ Borrower Agreement, clause 17.

¹⁶ Investor Agreement, clauses 11 and 15(b).

¹⁷ Borrower Agreement clause 18, Loan Contract clause 5.

¹⁸ Borrower Agreement clause 19.

¹⁹ Borrower Agreement clause 19(b). See also Loan Disclosure "Application of Loan" for the Borrower's authorisation to the creditor to transfer the relevant amount to Harmony.

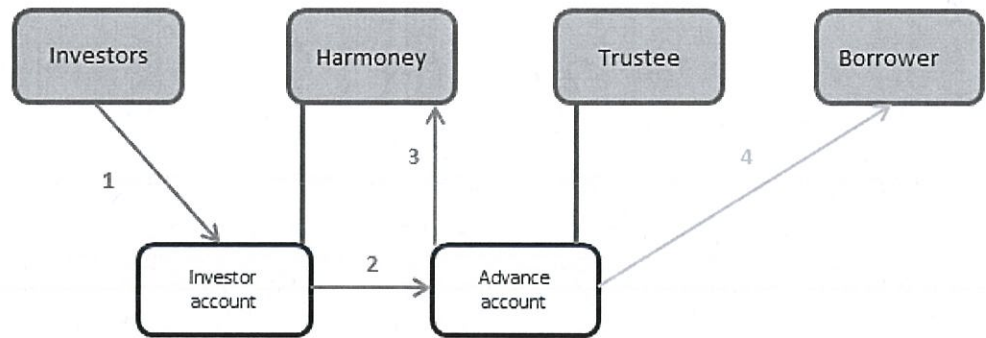
²⁰ Borrower Agreement, clause 44. The investor agreement describes the fee as the fee owed "in respect of a loan which settles" (clause 73), but little turns on this.

²¹ Loan Contract clause 7.

²² Loan Contract clause 9 (c)

²³ Investor Agreement, clause 53(a).

²⁴ <https://www.harmony.co.nz/how-it-works/interest-rates-and-fees> [accessed 8 June 2016].



12 In the above illustration, the green arrows represent the flow of the total Loan Amount (which includes an amount equivalent to the Platform Fee) from the investors to the investor account (1), and then to the advance account (2). The purple lines show the trustee of each account.

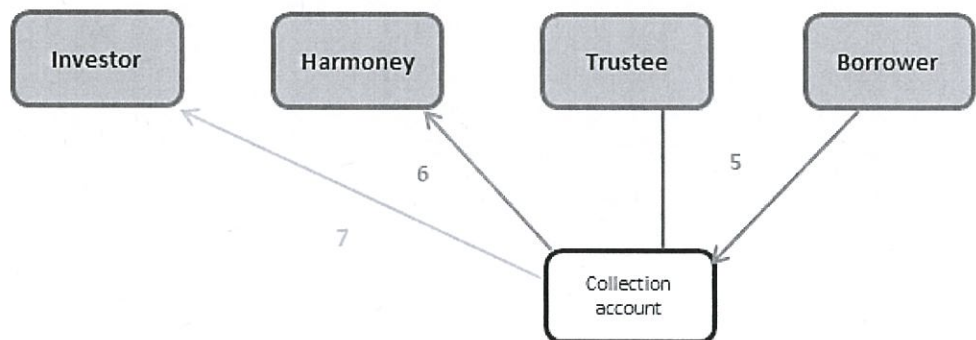
13 An amount equal to the Platform Fee (represented by the blue arrow) was then transferred to Harmony (3), while the balance of the Loan Amount (as represented by the yellow arrow) was advanced to the borrower (4).

14 Immediately upon settlement, the borrower had an obligation to repay the Loan Amount.

15 Harmony charges the Platform Fee to borrowers who apply for and are successful in having a Loan funded. Until December 2015, the Platform Fee was calculated on a variable rate, between 2 to 6 per cent of the Loan Amount, minus the amount of the Platform Fee itself (with a minimum fee of \$300, rounded to the nearest \$25). The applicable percentage rate varied based on Harmony’s assessment of the borrower’s credit risk; the riskier the borrower, the higher the Platform Fee as a percentage of the loan. The total dollar amount of the Platform Fee was therefore determined by the amount actually borrowed and the applicable percentage rate.

Repayments

16 Upon receipt of the loan (being the Loan Amount minus the Platform Fee), the borrower had an obligation to repay the Loan Amount, plus interest, to the Trustee. This aspect of the transaction can be illustrated as follows:



17 In this case, the green arrow represents the flow of the repayments from the borrower into the collection account (5). The collection account is held by the Trustee (as represented by the purple line) for the benefit of the participating investor(s).

- 18 Once payments were received into the collection account, the Trustee made the deductions owed to Harmoney, including investor fees and, where applicable, Harmoney's actual collection costs,²⁵ as represented by the blue arrow (6). The remaining funds were then advanced to the investors, as represented by the yellow arrow (7).

December 2015

- 19 Following discussions with the Commission, in December 2015 Harmoney ceased calculating the Platform Fee as a percentage of the Loan Amount and instead began charging a fixed fee on all new loans. In doing so, Harmoney reserved its position as to the issues in this case stated.

Annexures: Administration Deed (version as at 17 September 2015)
Administration Deed (amended version as at 29 October 2015)
Borrower Agreement
Investor Agreement
Loan Contract
Loan Disclosure (Sample: version as at 3 September 2014)
Loan Disclosure (Sample: amended version as at 11 November 2015)

²⁵ Investor Agreement, cl 54.