

Penalties test clarified by the High Court

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Yesterday, the High Court provided clarity around the doctrine of penalties in the much anticipated judgment handed down in *Paciocco v Australia and New Zealand Banking Group Limited* [2016] HCA 28.

The High Court made the finding that late payment fees on a credit account were not penalties, and the conduct of charging these fees did not amount to unconscionable conduct, unjust transactions or unfair contract terms under the relevant legislation.

Andrews v ANZ

Paciocco has seen an expansion of the doctrine of penalties previously affirmed in *Andrews v ANZ*.

In 2012, the High Court affirmed that the correct approach in determining whether a penalty existed required consideration of whether the fee was:

1. to secure performance of a primary obligation, such as compelling a customer to make monthly repayments on a credit card on time; or
2. for further services and accommodation, such as a request from a customer for the bank to extend their credit limit.

Paciocco v ANZ

Facts

Paciocco v ANZ was initiated in 2013 to test the reasoning in *Andrews v ANZ*. Like *Andrews v ANZ*, this case was a class action under *Pt IVA of the Federal Court of Australia Act 1976* (Cth). Mr Paciocco, on behalf of the class, claimed charges of various fees by ANZ were penalties, and therefore, unenforceable.

First Instance

Justice Gordon determined that credit card late payment fees were considered penalties. Her Honour found that the late payment fee charged by ANZ was a penalty, extravagant and unconscionable compared to the loss ANZ would actually suffer. The Court determined the quantum of loss occasioned by ANZ to range between \$0.50 and \$5.50, albeit the charges to Mr Paciocco's account were either \$20 or \$35. On this basis, Mr Paciocco was entitled to receive the difference between the credit card late payment fees paid to ANZ and the actual loss suffered by ANZ, adjusted to account for interest.

With regards to the other fees, such as honour fees, dishonour fees, non-payment fees, overdraft and overlimit fees, Justice Gordon found these were not penalties, and the charging of them did not constitute unconscionable conduct

or unfairness under the relevant legislative provisions. Her Honour reasoned that an attempt by a customer to overdraw or extend their credit limit was not a breach of contract. The customer had entire control of the request, and the bank was not obliged to grant the request. However, the granting of such credit constituted further services and accommodation. To this end, Justice Gordon commented that the fees were neither exorbitant nor unconscionable, leaving the fee limit to be determined by market forces.

Justice Gordon also considered whether the bank had acted unconscionably and whether the terms of the contract were unfair, under the relevant legislation.[1] However, these arguments were dismissed on the basis they had not been successfully prosecuted.

Appeal

On appeal in the Full Court of the Federal Court, Chief Justice Allsop upheld ANZ's appeal but dismissed the appeal of Mr Paciocco.

In respect of the late payment fees, Allsop CJ agreed with Justice Gordon's approach, but disagreed with the finding that late payment fees were penalties as Mr Paciocco had not proven the amounts to be extravagant or unconscionable. In this respect, Allsop CJ held that an actual loss analysis should have been conducted after the fees were ascertained as penalties, based on forecasts not actual results, to determine whether the level of fees was extravagant or unconscionable at the date of the contract.

The Full Court also agreed that the conduct of ANZ was not unconscionable, unjust or unfair under the relevant legislation. The Full Court held the fees could have been avoided by the conduct of the customer. Further, the terms were clear, and there was no evidence of unfair pressure, undue influence or unfair tactics. Allsop CJ dismissed Mr Paciocco's appeal with respect to other fees, which included honour fees, dishonour fees, non-payment fees, overdraft and overlimit fees, on the basis he had not proven the requisite unconscionability, unjustness or unfairness.

High Court Decision

The ANZ and Mr Paciocco appealed to the High Court, arguing respectively:

1. The Full Court erred in determining that charging late payment fees was not unconscionable and the contractual terms were not unfair; and
2. The Full Court erred in finding the late payment fees were not penalties.

The majority of the High Court held (Kiefel, Keane, Gageler JJ with Nettle J dissenting):

1. Late payment fees were not a penalty for the following reasons:

(a) The majority of the High Court relied upon the previous tests in *Clydebank*, *Dunlop*, *Ringrow* and *Andrews* to form the relevant test, being whether the late payment fee was "out of all proportion" to ANZ's interests in receiving the monthly payment.

(b) The majority upheld the Full Court's characterisation of the relevant interests impacted by the late payment, namely, operational costs, loss provisioning and increases in regulatory capital costs. In addition, Gageler J held that the stipulation of the late payment fee was 'not merely in terrorem; and not just a punishment.'

(c) Despite the fact the late payment fee was not a genuine pre-estimate of damage and the \$20 and \$35 sums were disproportionate to the actual loss

suffered, the appellants failed to establish the test, thus the appeal was dismissed.

2. The charging of late payment fees did not amount to unconscionable conduct, unjust transactions and unfair contract terms under the relevant legislation.

The High Court dismissed the appeal based on merits, agreeing with Full Court's decision.

What does this mean?

This decision provides additional comfort to lenders as it affirms the right of lenders to charge customers late fees if the failure to make payments on time causes the lender to incur costs in the form of additional capital expenditure. It also has wider implications enabling lenders to justify higher interest rate charges on defaulting accounts if they can establish that the charging is not 'out of all proportion' to their interests.

[1] *Australian Securities and Investments Commission Act 2001* (Cth) ss 12CB, 12CC, 12BG; *Fair Trading Act 1999* (Vic) ss 8, 8A, 32W, 32X; *National Consumer Credit Protection Act 2009* (Cth) Sch 1 s 76.

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