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Paciocco v Australia and New Zealand Banking Group Ltd

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On 5 February 2014, the Federal Court of Australia gave detailed consideration to the issue of fees as penalties in the representative proceeding[1] *Paciocco v Australia and New Zealand Banking Group Ltd*.[2] Justice Gordon handed down her decision concerning whether bank fees charged by Australia and New Zealand Banking Group Ltd (ANZ), including credit card late payment fees (Late Payment Fees) and honour fees, dishonour fees, non-payment fees and over-limit fees (together, Other Fees), were penalties or otherwise unconscionable under relevant legislation.[3] While Gordon J held that the Late Payment Fees charged by banks were penalties at both common law and equity, the decision was not the overwhelming consumer victory it may seem. The Other Fees imposed by ANZ were not found to be penalties or otherwise charged in contravention of the various statutory unconscionable conduct provisions. Therefore, both sides claimed victory, and both sides are still contemplating whether to appeal. While this much-anticipated clarity around the doctrine of penalties in *Paciocco* may be short lived, companies and banks are still closely analysing the implications for them.

Background

There is a lot of history in the recent representative actions regarding bank fees, starting on 22 September 2010 when the first class action was commenced in the Federal Court against ANZ by a group of customers in respect of fees as penalties, in *Andrews v Australia and New Zealand Banking Group Ltd*[4] (*Andrews FCR*). In this case, Gordon J held that the majority of those fees could not be penalties as they were not payable on breach of contract — with the exception of the late payment fees, which were capable of being penalties.

This question was then removed to the High Court for consideration, and in late December 2012 the High Court delivered a decision in *Andrews v Australia and New Zealand Banking Group Ltd*[5] (*Andrews HC*) that overturned recent case law on penalties that dictated that breach was an essential element in determining whether a fee is a penalty. Rather, *Andrews HC* found that the correct approach is to ask whether the purpose of the fee is to secure performance of a primary obligation by the party subject to the fee, or whether the fee is truly a fee for further services or accommodation. If it is a fee for further services or accommodation, it will not be a penalty even where it is significant. *Andrews HC* held that if the fee is payable to secure performance of the party subject to the fee, it will only be enforceable if it is a genuine pre-estimate of the damage suffered as a result of that party's non-performance.[6]

The accepted understanding of the law of penalties in Australia significantly changed as a result of *Andrews HC*. However, judicial guidance has been sparse since then, with no real practical application of the *Andrews HC* judgment — until *Paciocco*. In 2013, a representative action was commenced against ANZ with lead applicant Mr Paciocco in order to test the *Andrews HC* decision.

Paciocco — the facts

The applicants, Mr Paciocco and one of his companies, Speedy Development Group Pty Ltd (SDG), held a consumer deposit account and two consumer credit card accounts (in Mr Paciocco's name) and a business deposit account (in SDG's name).[7] Like most — if not all — Australian banks, ANZ imposed a variety of fees on its customers, including for Mr Paciocco a Late Payment Fee of $35 (which was reduced to $20 after December 2009), and Other Fees consisting of honour fees, over-limit fees, dishonour fees, outward dishonour fees and overdraft fees of between $20 and $37.50.

Mr Paciocco and SDG alleged that the contractual terms entitling ANZ to charge these fees constituted penalties at common law and in equity.[8] Alternatively, if the fees did not constitute penalties, then the applicants contended first that ANZ engaged in unconscionable conduct;[9] second that the consumer credit card accounts were unjust;[10] and third that the exception fee provisions in Mr Paciocco's consumer deposit account and consumer credit card were unfair contract terms.[11]

For the reasons outlined below, in February 2014 Gordon J handed down her findings that Late Payment Fees are penalties both at common law and in equity, and should be repaid by ANZ with no retrospective time limitation on claims. Justice Gordon found in favour of ANZ on the Other Fees, deciding that they were of a different character and none constituted a penalty at

common law or in equity.[12] This decision provides the first major application of the principles outlined in the somewhat controversial *Andrews HC* decision.

Paciocco — the decision and reasoning

Late Payment Fees

On 5 February 2014, there seemed little doubt that Gordon J would again find that the Late Payment Fees were penalties both at common law and in equity, as she had in *Andrews HC*. Her Honour considered that under the relevant contracts with ANZ, Mr Paciocco was obliged to pay a minimum amount by a certain time each month and therefore Late Payment Fees were levied upon either a breach of this obligation, or as a collateral fee to be regarded as security for, or *in terrorem of*, performance of this obligation.[13] A failure to do so by Mr Paciocco was a breach of contract and would attract a Late Payment Fee. This was because the obligation to pay the fee (the collateral stipulation) arose upon a breach or failure to comply with an obligation to pay on time (the primary stipulation). Further, the fee or collateral stipulation imposed on Mr Paciocco an additional detriment in the nature of a security for the satisfaction of the primary stipulation, which was extravagant, exorbitant and unconscionable.[14] By "additional detriment", the court meant a detriment that exceeded the prejudice to the bank caused by the customer's failure to pay by the due date.[15]

Significant in its findings, the court noted that the Late Payment Fees were the same fees payable regardless of whether Mr Paciocco was one day late, one week late or longer, and regardless of whether the overdue amount was 1 cent or $1000, or more.[16] The court held that this disregard as to whether or not the failure was serious gave rise to a presumption that the Late Payment Fees were penal.[17] The fact that the Late Payment Fees were provided for in a non-negotiable standard form of contract was also a relevant factor.[18]

Notwithstanding the difficulties in ascertaining what an appropriate fee would be, Gordon J estimated that the maximum loss that might be suffered by ANZ in respect of each fee charged was only between $0.50 and $5.50 (depending on the specific fee), in contrast to the fees of $35 or $20 charged by ANZ.[19] As a result, Gordon J held that Mr Paciocco was entitled to receive the difference between the credit card late payment fees paid to ANZ and ANZ's actual loss, adjusted to take into account interest.

As Mr Paciocco's claim comprised 72 fees, of which he was successful on 26, the total award was a relatively insignificant $640, less an amount representing a reasonable fee, plus interest. However, banks should be aware that the quantum of this judgment could run into the tens of millions of dollars when losses of all group members are quantified.

Other Fees

In contrast, the Other Fees were deemed to be of a character different from the Late Payment Fees, and were held not to be penalties because these were imposed as consideration for the provision of further services. When exceeding a credit card limit, a customer is not breaching the contract.[20] Rather, an attempt by a customer to overdraw an account should be considered as a request by the customer for further credit. This request is then considered and either accepted or declined by the bank (even if automatically or electronically). The making of such a request was entirely within the customer's control (subject to credit limit) and required the consensual conduct of both the customer and ANZ.[21] As a consequence of the further accommodation (or benefit) provided by the bank in the above circumstances, the Other Fees were held to be in contrast to the Late Payment Fees and were not penal in nature.[22]

Unconscionable conduct

Justice Gordon was also asked to consider whether ANZ engaged in unconscionable conduct in respect of its accounts under the Australian Securities and Investments Commission Act 2001 (Cth) (ASIC Act),[23] whether the transactions were unjust transactions under the applicable Consumer Credit Codes,[24] and whether the contract terms were unfair terms under the Victorian Fair Trading Act 1999 (Vic)[25] or the ASIC Act.[26] In short, her Honour rejected each of these arguments, holding that circumstances indicative of unconscionability, unjustness or unfairness had not been made out.[27]

Limitation period

Another interesting issue for banks that arose was whether some of Mr Paciocco's claims were barred under the Victorian Limitation of Actions Act 1958 (Vic),[28] which provided for a six-year limitation period[29] from the event giving rise to the claim. Mr Paciocco argued that he was entitled to rely on s 27 of the Limitation of Actions Act, which extended limitation periods in the case of mistake. He claimed that he operated under the belief that ANZ was entitled to charge the exception fees and that the limitation period did not begin to run until he discovered his mistake. Worryingly for banks, the court held that s 27 of the Limitation of Actions Act applied in the applicants' favour,[30] holding that "mistake" applies to mistake of law as well as fact.[31] Therefore, the relevant time for

bringing an action against ANZ only started running from the first proceeding of the *Andrews FCR* on 22 September 2010.[32]

Consequences of the Paciocco decision for banks

In light of the *Andrews HC* and *Paciocco* authorities, it is critical for companies and banks to turn their mind to the question of whether certain types of fees payable under commercial contracts (for example, break fees or non-performance fees) are capable of constituting penalties and therefore unenforceable.

Consideration for services or genuine pre-estimate of costs

This was the first case brought against a financial institution challenging the lawfulness of the fees imposed in the course of providing financial services. Although the finding was not completely in the applicants' favour, this decision certainly causes concern for banks and companies that routinely impose break fees, default fees or late payment fees. *Paciocco* means that such companies and banks will need to be able to demonstrate that the fees they charge are justified on the basis that the fee is consideration for providing an additional service, or a genuine pre-estimate of the cost to the business of an event. All banks should review their fees, especially if they apply without any grace period.

In particular, a fee imposed for late payment (without any additional service, such as extended credit) may be subject to the law of penalties. If a flat rate is charged regardless of the period or amount overdue, this will give rise to the presumption that the fee is penal in nature.

Debit bank default fees only after default

Payment default fees debited to the account right after the default and before the financier has incurred loss or cost may be difficult to justify. Ideally, banks should debit default fees after the financier has incurred the cost and after the payment default has remained unremedied for a certain period. Examples of costs may include relevant system and staff costs and the cost of contacting the borrower about the arrears by phone, email or post.

Class action and regulatory risk

It is essential that banks which collect fees understand that, should those fees subsequently be found to be penalties, they are not only unable to recover that fee, but may be obliged by a class action or the Australian Securities and Investments Commission to refund similar fees charged to other customers for the amount by which the fee exceeds the reasonable cost.

Carefully drafted contracts

Paciocco is also likely to also have an impact upon commercial arrangements and the drafting of commercial contracts by companies and banks. The "operative distinction" is a fine one, but an important one for banks to understand. Although *Andrews HC*[33] purports to draw focus on the substance of the collateral stipulation rather than the form, the *Paciocco* decision confirms that the operative distinction leaves room for contractual drafters to avoid the doctrine of penalties. Accordingly, banks and companies utilising standard form contracts should take some comfort that their contracts can be carefully drafted to avoid the penalty doctrine by providing some form of further accommodation or benefit in exchange for what might otherwise be a penal stipulation.

Concluding comments

The *Paciocco* decision is significant because it provides a concise statement of the principles provided in *Andrews HC*, and confirms how the redefined doctrine of penalties now applies in the context of widely charged bank exception fees. It will also have an immediate effect on a number of other fee class actions that have commenced against other major Australian banks, where the *Paciocco* principles and findings may expedite any potential settlement of these class actions and largely confine the scope of any further hearings.

The future of the *Paciocco* litigation, however, remains unknown. ANZ may appeal Gordon J's decision, most likely on the grounds that the fees were not extravagant or unconscionable. Mr Paciocco may also appeal, on the grounds that the Other Fees come within the High Court's expansion of the penalty doctrine and, of course, were extravagant and unconscionable. Solicitors for the other banks defending similar class actions by their customer will be carefully scrutinising Gordon J's decision and, like all other banking and finance institutions, will be keenly watching for any appeal from that decision.

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Leonie Chapman's *experience extends to banking and finance, consumer credit and mortgage lending, contract negotiation, trade practices and fair trading legislation, intellectual property and trade marks, and corporate and financial services. After completing her Bachelor of Laws and Bachelor of Commerce in 2002, Leonie worked in private practice and as senior in-house*

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Footnotes

1. Federal Court of Australia Act 1976 (Cth), Pt IVA.
2. *Paciocco v Australia and New Zealand Banking Group Ltd* [2014] FCA 35; BC201400298.
3. Australian Securities and Investments Commission Act 2001 (Cth); Fair Trading Act 1999 (Vic); National Credit Code (Sch 1 to the National Consumer Credit Protection Act 2009 (Cth)).
4. *Andrews v Australia and New Zealand Banking Group Ltd* (2011) 211 FCR 53; 288 ALR 611; [2011] FCA 1376; BC201109353.
5. *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205; 290 ALR 595; [2012] HCA 30; BC201206622.
6. Above, n 5.
7. Above, n 2, at [1].
8. Above, n 2, at [2].
9. Australian Securities and Investments Commission Act 2001 (Cth), ss 12CB, 12CC; Fair Trading Act 1999 (Vic), ss 8, 8A.
10. National Credit Code.
11. Fair Trading Act 1999 (Vic), s 32; Australian Securities and Investments Commission Act 2001 (Cth), s 12BG.
12. Above, n 2, at [4] and [5].
13. Above, n 2, at [4].
14. Above, n 2, at [4].
15. Above, n 2, at [46].
16. Above, n 2, at [119].
17. Applying the principles in *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* [1915] AC 79 at 87; [1914] All ER Rep 739; (1914) 83 LJKB 1574; 111 LT 862.
18. Above, n 2, at [95].
19. Above, n 2, at Annexure 1.
20. Above, n 2, at [4].
21. Above, n 2, at [307].
22. Above, n 2, at [271].
23. Australian Securities and Investments Commission Act 2001 (Cth), ss 12CB, 12CC.
24. Consumer Credit (Victoria) Code, s 70; National Credit Code, s 76.
25. Fair Trading Act 1999 (Vic), s 32W.
26. Australian Securities and Investments Commission Act 2001 (Cth), s 12BG.
27. Above, n 2, at [310].
28. Limitation of Actions Act 1958 (Vic), s 27.
29. Above, n 28, s 5.
30. Above, n 2, at [366].
31. Above, n 2, at [365].
32. Above, n 2, at [368].
33. Above, n 5.