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Paciocco v Australia New Zealand Banking Group Ltd

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On 27 July 2016, the High Court of Australia delivered its final decision in a long-running class action over bank fees, upholding the 2015 decision of the Full Court of the Federal Court that Australia and New Zealand Banking Group Ltd (ANZ) was entitled to charge late payment fees of up to $35, endorsing a "legitimate commercial interests" test.[1] The High Court majority (4 to 1) upheld that credit card late payment fees charged by ANZ (late payment fees) do not constitute penalties and are not otherwise unconscionable, unjust or unfair under relevant statutory provisions. The High Court found that the purpose of ANZ's late payment fee was not to punish customers but to protect ANZ's legitimate interests in light of the conceivable losses which may have resulted from non-payment when the credit card facilities were established, including making provisions for soured loans, for holding regulatory capital and for debt collection costs.[2]

This article, the second of two covering this case, analyses the High Court's findings in *Paciocco v Australia and New Zealand Banking Group Ltd*[3] (*Paciocco HCA*) and outlines some of the key implications for banking and financial institutions and lawyers. It follows a piece[4] in 2014 that discussed the Federal Court of Australia's consideration to the issue of fees as penalties in the representative proceeding[5] of *Paciocco v Australia New Zealand Banking Group Ltd*[6] (*Paciocco FCA*). Banking and finance institutions are now closely analysing the implications in the wake of the High Court decision in *Paciocco FCA*, some of which are explored in this article.

History of bank fee actions

There has been extensive activity in recent representative actions regarding bank fees, starting on 22 September 2010 when the first class action was commenced against ANZ by a group of customers in respect of fees as penalties in *Andrews v Australia and New Zealand Banking Group Ltd*[7] (*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 Australian and New Zealand Banking Group Ltd*[8] (*Andrews HCA*) that overturned recent case law on penalties which dictated that breach was an essential element in determining whether a fee is a penalty. Rather, in *Andrews HCA*, it was 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. In *Andrews HCA*, it was held that if the fee is payable to secure the 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.[9]

The accepted understanding of the law of penalties in Australia significantly changed as a result of *Andrews HCA*; in 2013, another representative action was commenced against ANZ, with lead applicant Mr Paciocco, in order to test the *Andrews HCA* decision. Not surprisingly, in February 2014, Gordon J handed down her findings in *Paciocco FCA* that late payment fees were penalties both at common law and in equity, and should be repaid by ANZ with no retrospective time limitation on claims. In that decision, Gordon J accepted the applicants' evidence that damage to ANZ resulting from late credit card payments was limited to the direct costs associated with the recovery of outstanding payments. The late payment fee charged by ANZ substantially exceeded the amount of damages that could be awarded for a breach of the obligation to pay the monthly payments by the due date; therefore, her Honour held that the late payment fee constituted a penalty. Gordon J found in favour of ANZ that non-payment fees and overlimit fees (other fees) were of a different character and were not penalties or otherwise charged in contravention of the various statutory unconscionable conduct provisions.[10]

On appeal by both parties to the Full Court of the Federal Court on 8 April 2015, the appeal judgment delivered in favour of ANZ on its appeals and against Paciocco on its appeals — notably deciding that the late payment fees were legitimate because they contemplated a broader range of potential costs to the bank, including the impact on provisioning for bad debt and regulatory capital. Then, upon being granted leave from the Full Federal Court of Appeal, the ANZ customers appealed to the High Court of Australia, who heard two matters concurrently: the penalty claims and the statutory claims. In July of this year, the majority of the High Court dismissed Paciocco's case with costs and after a substantial amount of discussion was entered in relation to the manner in which the late payment fee was quantified.

Paciocco — the facts

To briefly refresh your memory on the facts: the applicants, Mr Paciocco and one of his companies that is Speedy Development Group Pty Ltd (SDG), held a consumer deposit account, two consumer credit card accounts (in Mr Paciocco's name) and a business deposit account (in SDG's name).[11] Like most if not all Australian banks, ANZ imposed a variety of fees on their customers, including a late payment fee of $35 for Mr Paciocco (which was reduced to $20 after December 2009) and other fees consisting of honour fees, overlimit 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.[12] Alternatively, if the fees did not constitute penalties, then the applicants contended that:

- first, ANZ engaged in unconscionable conduct;[13]
- second, the consumer credit card accounts were unjust;[14] and
- third, the exception fee provisions in Mr Paciocco's consumer deposit account and consumer credit card were unfair contract terms.[15]

Paciocco HCA — the decision and reasoning

The penalty claims

A difference in construction of each party's respective expert accountant formed the basis of whether, in the mind of the High Court, the late payment fee constituted a penalty. In *Paciocco FCA,* Gordon J held that a stipulation will not constitute a penalty at law or in equity unless it is "extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved".[16] Her Honour went on to hold that the evidence adduced by ANZ's expert accountant in relation to ANZ's conceivable costs other than solely the operational costs in exercising its collection of the fee and reasonable charges incurred, was a "theoretical accounting" exercise[17] and simply part of the "costs of running a bank in Australia". The other costs claimed by ANZ were "too remote to be compensable" by a late payment.[18]

The Full Federal Court and the High Court did not need to address the quantum of the calculation; however, Keane J notes that he believed that evidence of the actual damage suffered by ANZ was relevant as to whether the late payment fee was a penalty.[19] Keane J went on to say that a bank provides financial accommodation in the form of standard form credit contracts to its borrowers and it is able to therefore consider the risk and financial implications if every credit card holder defaulted at the same time.[20]

The Full Federal Court overturned the decision in *Paciocco FCA* based on a view that the fees incurred by ANZ were more than just the operational costs and could also include costs such as provisioning and regulatory capital costs. Allsop CJ of the Full Federal Court stated that "the correct approach [is] to look at the greatest possible loss on a forward looking basis", noting that extravagance or exorbitance is to be measured with reference to the offended party's legitimate interest[21] or with regard to the innocent party's interest in the performance of the contract.[22] A credit provider's interests are loss prevention for its profit and loss, the requirement to hold regulatory capital sufficient to cover unexpected losses and also the operational cost, which according to *Paciocco HCA* were all legitimate costs of running a bank.[23]

Gageler and Keane JJ of the High Court concluded that the Full Federal Court was correct that Paciocco "failed to demonstrate that the late payment fee was a penalty".[24] Keane J confirmed the position of Allsop CJ of the Full Federal Court that the appellants "chose to run their affairs by risking the fees". Keane J further stated that Paciocco made a rational decision to pay the late payment fees and therefore, the fees were "not of sufficient magnitude as to make the choice inconvenient for him as a matter of business",[25] referring to it as "a voluntary and self-interested choice".[26]

The statutory claims

The High Court also dismissed the appeal in respect of the statutory causes of action, with the majority rejecting claims that ANZ's conduct was unconscionable, unjust or unfair on their merits. Gageler J concurred with the decision of the Full Federal Court[27] in relation to the statutory claims made by ANZ consumers, stating that ANZ did not cause Mr Paciocco to enter

into credit card contracts which contained what was, in the language of s 12CB(2)(b) of the Australian Securities and Investments Commission Act 2001 (Cth) (ASIC Act), the "condition" for the late payment fee; it rather presented him with a standard form contract on a take-it-or-leave it basis. Further, ANZ did not cause Mr Paciocco to fail to make minimum monthly payments as a result of which he became subject to the requirement to pay the late payment fee. In his Honour's view, there was no conduct on the part of ANZ which enlivened the operation of s 12CB(2)(b) of the ASIC Act.[28] This rationale was echoed in the judgment of Keane J.[29]

Further, in relation to whether or not charging the late payment fee was unconscionable,[30] Gageler J confirmed that Mr Paciocco freely entered into the credit contracts without any suggestion of undue influence, pressure or tactics on the part of ANZ,[31] and at any time, Mr Paciocco could have exercised his right to take his business to another credit provider. Instead, Mr Paciocco elected to enter into the contracts and chose to continue to manage his accounts by making payments after the due date, despite having received, read and understood the documents prior to signing them, as well as subsequent phone calls from ANZ advising the late payment fee is payable if he did not make minimum due payments by the date on the statement. The High Court said that:[32]

> … even if … the late payment fee resulted in windfall gains to ANZ … the proper conclusion still to be drawn would be that ANZ did not engage in unconscionable conduct within the meaning of s 12CB(1) of the ASIC Act [in charging late payment fees] …

Gageler J further found Paciocco's argument for breach of s 76 of the *National Credit Code (NCC)* to be reflective of the arguments brought under the ASIC Act as well as for the arguments brought under s 32W of the Fair Trading Act 1999 (Vic) (FTA)[33] and therefore, the High Court said: "The argument must suffer the same fate, for substantially the same reasons."[34]

Dissenting judgement of Nettle J

It should be noted that Nettle J was in dissent and would have allowed the appeal, adopting a more rigid approach to considering the scope and application of the test to determine whether a fee is a penalty. Nettle J found that loss provisioning, regulatory capital and some operations costs could not be taken into account by ANZ because in many cases, they were future costs not ultimately incurred by ANZ. His Honour focused on the fee being fixed regardless of the seriousness or triviality in time or amount of late payment and agreed with Gordon J in *Paciocco FCA* that assessing the greatest recoverable loss should be by reference to what would be recoverable in unliquidated damages.[35]

Consequences of the decision for banks

Credit contracts

Paciocco HCA is likely to also have an impact on commercial arrangements and the drafting of commercial contracts by companies and banks. The court is now clear that only contractual provisions or promises operating as a punishment will be penalties. A provision will be a punishment when the punishment is out of all proportion for the protection of interests of innocent party. Banks can now discard any preconceptions about "genuine pre-estimate of recoverable loss" found in *Paciocco FCA* and can take into account things other than recoverable loss in determining the interests of the bank. Accordingly, banks and companies utilising standard form contracts should take some comfort that their contracts can be carefully drafted to avoid the penalty doctrine.

In *Paciocco HCA*, the High Court ruled that $20 and $35 were not extravagant to protect ANZ's legitimate interests. The plaintiffs approached the case with "direct costs" arguments and did not call any evidence regarding the "other interests" of ANZ. This was detrimental to their case as the person making a challenge dealing with penalties (in this case, Paciocco) holds the onus of proof.

Some of the matters banks can now consider in recovery through fees include loss provisions, increased regulatory capital to recognise loss, operational costs of following up payment and might also include employing telephone attendants to call customers and follow up. These are losses a bank could not ordinarily sue for and recover from a consumer, but nonetheless were real costs of the bank. A prudent approach for banks in the wake of *Paciocco HCA* would be to seek to identify these sorts of interests and then consider whether a fee being charged that is designed to protect those interests is imposed as a punishment or a mere protection of those interests, reflected by proportionality. Looking at all the facts where a credit contract can justify a fee based on interests that go beyond mere direct recovery of loss, then a bank may be able to justify that a fee protects its interests.

Importantly, the decision signals at the very least that courts may be reluctant to interfere with contractual provisions of this kind and will take a broad view as to the legitimate commercial interests which the provision seeks to protect. Parties should be left to contract commercially and in doing so, should be able to contract to protect their own interests. Keane J quoted Mason and Wilson JJ in saying that courts should not too readily interfere with the parties' right to settle themselves a breach of contract, unless the purpose of the disproportion is punitive.[36]

Class actions

The decision also highlights that there will be great risk for consumer class action litigants, particularly those challenging bank fees. Class action applicants are generally keen to settle the case, as the risk of litigating in full is enormous. *Paciocco HCA* adds weight to consumer's motivation to settle and could give banks more power to settle on more beneficial terms for them. The decision in *Paciocco HCA* will likely bring an end to the numerous bank fee class actions commenced against other Australian banks which had been stayed pending in this decision. Aside from the impact on banks, the legal principles being debated in the case might have implications for other late payment fees, such as those charged by electricity and telecommunications companies as other "fee" class actions were commenced against telecommunications and utilities companies.[37]

Pre-estimate of costs

While ANZ were successful despite admitting from the outset that they did not do any pre-estimate of recoverable loss when setting the late payment fees, banking and finance institutions should continue to conduct pre-estimates of cost in determining consumer fees, as doing the exercise upfront can help make sure you are prepared.

What should banks take into account in setting fees? Kiefel J says "[a] sum out of all proportion to the interest protected" will be a penalty, which gave little help in providing banks with a clear rule in setting fees. Rather, Kiefel J confirmed that banks need to be able to justify their fees. It is difficult to assess what fee is a punishment or a negative incentive; however, words like: "extravagant", "exorbitant" and "unconscionable" are generally used to describe punishments. Therefore, it is recommended that the total costs and interests calculated by a bank should come close to the fee being charged to consumers to reduce the risk of challenge as a penalty.

This case does show that ANZ did not have to prove the existence of other interests or that somebody took those other interests into account when setting the fee. Justification after the fact appeared to be accepted by the High Court. However, Andrew Watson, lawyer for the ANZ customers and Maurice Blackburn's national head of class actions, said that the Full Federal Court's decision was based on "an absurdity … that the bank is entitled to take into account every conceivable cost that might possibly ever occur when a late payment is made".[38]

If, after conducting the calculation, banks feel the fee needs to be justified better, then language could be added to credit contracts to ensure it is clear what the fee is seeking to recover. Further, banks should consider obtaining acknowledgements from customers that the bank incurs other costs not immediately apparent to consumers in the event of late repayment.

Consumer protection

What will be the outcome of this decision for future consumer protection? Will it give the green light for banking and finance institutions to increase fees, sparking calls for the government to step in? CHOICE's CEO Alan Kirkland argued the ruling would allow banks to continue its "fee frenzy".[39] It is already not unusual for credit card providers to charge a $35 late payment fee to consumers. Andrew Watson said that the ruling meant bank customers had no way of challenging fees that did not reflect their bank's costs.[40]

Even worse news for consumers, before *Paciocco HCA*, they had fall back positions regardless of whether bank fees were penalties, in that imposing the fee contravenes statutory provisions, including provisions of the ASIC Act,[41] FTA[42] and *NCC*.[43] *Paciocco HCA* found that Mr Paciocco was not a worthy complainant for these types of complaints and in a class action where there is a shared common complaint by all; delving into specific facts under these pieces of legislation are difficult to prove.

It is useful for banking and finance lawyers to note when defending banks against unconscionable conduct claims, that Allsop CJ in the Full Federal Court decision provided detailed guidance on the meaning of unconscionable conduct, which the High Court did not depart from. Keane J emphasised that the existence of a disparity in bargaining power alone is not enough to establish that the party enjoying the superior power has acted unconscionably by exercising it. To focus on inequality of bargaining power is to ignore the words of the statute which requires conduct to be unconscionable "in all the circumstances".[44]

Further regulation?

Consumer advocates believe that the ball is now firmly in the government's court to provide consumers with real protection from banks who use fees to gouge customers. Some have been very scathing of the *Paciocco HCA* decision, believing big banks now have the run of the game. However, according to French CJ, Australia cannot address these issues through the law of penalties. French CJ noted that the penalties doctrine has been haphazardly developed and if society believes consumers are getting a rough deal, then it must legislate. In light of comments from the Consumer Law Action

Centre's CEO Gerard Brody who said late repayment fees were most damaging to customers on lower incomes, many say the government should now "tip the balance" in favour of consumers. Australian banking and finance institutions and their lawyers will certainly be closely monitoring for any regulatory reform in the pipeline.[45]

Concluding comments

The *Paciocco HCA* decision is significant because it provides welcome clarity on the application of the penalty rule. Particularly for banking and finance institutions, the decision provides greater commercial certainty in continuing to charge late payment fees.[46] The High Court decision most certainly casts serious doubt over the future of other penalties class actions in the pipeline against banks, as well as other businesses in a broad range of sectors. Banking and finance institutions can take comfort and guidance from the decision in *Paciocco HCA* which permits the protection of a broader array of "legitimate interests" in a range of clauses of this kind. As banks breathe a sigh of relief in relation to pending class actions which were heavily relying on the outcome of *Paciocco HCA*, and start to recalculate fees and redraft contractual provisions in light of guidance from this High Court decision, their lawyers will be keeping a close eye on consumer advocates and legislators for the possibility of change in laws to address consumer bank fees.

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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, corporate and financial services. After completing her Bachelor of Laws and Bachelor of Commerce in 2002, Leonie went on to work both in private practice and as senior in-house lawyer supporting a specialist lender and then for 6 years, Macquarie Bank Ltd. Having achieved a Master of Laws in 2009 specialising in banking and finance law, Leonie's main focus now as Principal of LAWYAL Solicitors is on regulation and compliance for banking and financial institutions.

Footnotes

1. *Paciocco v Australia and New Zealand Banking Group Ltd* (2016) 333 ALR 569; [2016] HCA 28; BC201606134.
2. C Yeates, *ANZ Bank Wins in High Court Bank Fee Case*, 27 July 2016, at www.smh.com.au.
3. Above n 1.
4. L Chapman "Paciocco v Australia and New Zealand Banking Group Ltd" (2014) 30(4) *Australian Banking & Finance Law Bulletin* 62.
5. Federal Court of Australia Act 1976 (Cth), Pt IVA.
6. *Paciocco v Australia New Zealand Banking Group Ltd* (2014) 309 ALR 249; [2014] FCA 35; BC201400298.
7. *Andrews v Australia and New Zealand Banking Group Ltd* (2011) 211 FCR 53; [2011] FCA 1376; BC201109353.
8. *Andrews v Australian and New Zealand Banking Group Ltd* (2012) 247 CLR 205; [2012] HCA 30; BC201206622.
9. Above n 8.
10. Australian Securities and Investments Commission Act 2001 (Cth) (ASIC Act); Fair Trading Act 1999 (Vic) (FTA); and *National Credit Code* (*NCC*) (Sch 1 to the National Consumer Credit Protection Act 2009 (Cth)).
11. Above n 6, at [1].
12. Above n 6, at [2].
13. ASIC Act, above n 10, ss 12CB and 12CC; FTA, above n 10, ss 8 and 8A.
14. *NCC*, above n 10.
15. FTA, above n 10, s 32; ASIC Act, above n 10, s 12BG.
16. Above n 1, at [230].
17. Above n 1, at [230].
18. Above n 1, at [231].
19. Above n 1, at [244].
20. Above n 1, at [273].
21. Above n 1, at [236].
22. Above n 1, at [270].
23. Above n 1, at [238].
24. Above n 1, at [177].
25. Above n 1, at [217].
26. Above n 1, at [219].
27. Above n 1, at [202].
28. Above n 1, at [186].
29. Above n 1, at [286]–[305].
30. ASIC Act, above n 10, s 12CB(1).
31. Above n 1, at [193].
32. Above n 1, at [191] and [197].
33. Above n 1, at [198].
34. Above n 1, at [192].
35. Above n 1, at [340]–[341].
36. Above n 1, at [220]–[221].
37. Above n 2.
38. J Lee, *ANZ Class Action Begins Final Appeal in High Court*, 4 February 2016, at www.smh.com.au.
39. M Neil, *Warnings of a Credit Card Late Fee 'Free-For-All' After High Court Rules the Practice is Acceptable*, 28 July 2016, at www.news.com.au.
40. Above n 2.
41. ASIC Act, above n 10, ss 12CB and 12CC.
42. FTA, above n 10, ss 8 and 8A.

43. *NCC*, above n 10, s 76.
44. Allens, *Client Update: Penalties: The Final Word*, 27 July 2016, at www.allens.com.au.
45. Above n 2.
46. Above n 44.