BANKING FEES AND THE POWER OF A CONTRACT
2 August 2016

On 27 July 2016, the High Court of Australia released a long awaited decision clarifying the Australian approach as to whether late payment fees are unenforceable because they amount to penalties. In the case of *Paciocco v Australia and New Zealand Banking Group Limited* [2016] HCA 28, the majority judges of the High Court held that late credit card payment fees charged by the ANZ were valid and enforceable and not prohibited by statute.

Background

The ANZ proceeding was a class action commenced by class representative Mr Paciocco and his company, Speedy Development Group Pty Ltd. Mr Paciocco and his company (**appellants**) held multiple banking facilities with the ANZ bank, including credit card, business and savings accounts.

While banking with the ANZ, between 2008 and 2013, ANZ charged the appellants various banking fees such as late payment fees, overdraft fees, honour and dishonour fees. The bank would from time to time change its late payment fees without consultation with its customers.

The appellants argued that these banking fees were unenforceable as they violated the equitable and contractual doctrines against penalties and that even if the fees were enforceable at law, they were prohibited under consumer protection legislation such as the National Credit Code and/or constituted unconscionable conduct under the *Fair Trading Act 1999 (Vic)* and the *Australian Securities and Investment Commission Act* 2001*(Cth)*. The primary argument was that the $35.00 late fee payment charged by the ANZ was disproportionate to the cost suffered by the bank.

First instance decision and appeal

The appellants were initially successful. Justice Gordon of the Federal Court (who was subsequently appointed to the High Court) followed an earlier High Court case of *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205. In *Andrews*, the High Court found that a sum such as a fee, if it amounts to a penalty, is unenforceable if it amounts to a secondary sum that is contingent upon failure to pay the original sum owed (i.e. an additional detriment to the benefit of the other party). Justice Gordon ruled that late payment fees were the only fees that satisfied the definitional test for penalties and were therefore unenforceable.

The ANZ appealed the decision to the Full Federal Court and were successful in doing so. The Full Federal Court overturned Justice Gordon's finding in relation to late payment fees and held the other fees payable were enforceable. In upholding the various bank fees, the Full Federal Court found the fees were neither extravagant, unreasonable nor unconscionable when compared with the Bank's loss flowing from their customers' breaches.

High Court Decision

The appellants appealed to the High Court on two separate grounds. The first was that the late payment fees charged by ANZ were unenforceable as penalties (**penalty appeal**). The second ground was that the late payment fees contravened various statutory prohibitions against unconscionable conduct and unfair contract terms (**statutory appeal**). A majority of the High Court (Kiefel, Keane, Gageler JJ with Nettle J dissenting) dismissed the appeal on both counts.

With regards to the penalty appeal, the majority relied upon *Andrews* and found the relevant test was whether the late payment fee charged by ANZ was disproportionate to ANZ's interests in receiving on-time payments. The majority found that the ANZ incurred significant costs when their customers breached their payment obligations. ANZ adduced expert evidence showing that ANZ incurred costs including regulatory capital costs, collection costs and loss provision costs. The majority held that even though the late payment fee was not a genuine pre-estimate of loss, and even though the fee charged was higher than the bank's actual loss, the fee was not overly disproportionate or punitive in the grander context. The majority judges held the key test was whether a sum payable was 'out of all proportion' to the interests of the party which it is protecting, and not limited to a direct loss in damages resulting from the customers' failure to pay. An additional influential factor was Mr Paciocco freely entered into the credit card contracts with ANZ and had the right to terminate the contracts at any time, for any reason. More generally, the High Court was very conscious of the need to preserve basic freedom of contractual rights. The

Court did not consider such rights to have been breached by the late payment term agreed to by the ANZ and the appellants.

For similar reasons to the penalty appeal, the majority dismissed the statutory appeal, finding that the late payment fees were not disproportionate when contrasted against the bank's loss. As such, the ANZ did not breach consumer protection legislation.

Takeaway Lessons

This is clearly a welcome decision for multiple financial institutions, and associated industries including telecommunications, accounts receivable and other businesses reliant upon timely payments. This decision affirms that businesses have the right to charge customers late fees if it means the businesses will incur costs as a result of the late payments, so far as the fees are proportionate to the loss suffered.

More importantly, this decision represents a principled statement that the High Court values contractual freedom as a fundamental tenant of a capitalist economy. As noted by Justice Gageler, the courts will not lightly invalidate contractual provisions for agreed payments simply because the payment has the character or appearance of a penalty. Justice Keane similarly remarked that disparity in bargaining power between parties is a pervading feature of a capitalist economy, and the existence of such disparity is not indicative of any unconscionable conduct or impropriety by the Bank.

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