
High Court allows late payment fees

2 August 2016

Authors: Murray Deakin, Sylvia Ng, Ira Chaudhri

In brief

The High Court of Australia has dismissed a class action against Australia and New Zealand Banking Group Limited (ANZ) by finding that the bank's late payment fees to its credit card account holders were enforceable. The High Court held ANZ was entitled to charge customers late payment fees of up to \$35, having regard to the bank's provisioning, regulatory capital, and operational costs.

The bank's customers were unsuccessful in their claims that the late payment fees were unenforceable as penalties at common law, and further, that the contractual provisions imposing the late payment fees breached various statutes which prohibited unconscionable conduct and unjust and unfair terms.

Whilst this decision analysed the legitimacy of late payment fees in the banking industry, the Court's analytical approach is likely to have broader application to those in other industries (e.g. telecommunications and utilities) that also impose late fees.

In detail

Background

The class action on behalf of ANZ's customers, brought by Mr Paciocco, was premised on the claim that the provisions in their contracts with ANZ which charged various fees (including honor fees, non-payment fees, over-limit fees and late payment fees) were unenforceable as penalties and, alternatively, contravened various statutory provisions relating to unconscionable conduct, and with respect to Paciocco only, unjust and unfair contract terms.

The statutory claims against ANZ were that:

- (a) ANZ had engaged in 'unconscionable conduct' within the meaning of ss 12CB and 12CC of the *Australian Securities and Investments Commission Act 2001* (Cth) (ASIC Act) and ss 8 and 8A of the *Fair Trading Act 1999* (Vic) (FT Act) by entering into and implementing the standard contractual stipulation for the charging of the late payment fee, and

-
- (b) the credit card contracts were ‘unjust’ within the meaning of s 76 of the National Credit Code in Schedule 1 to the *National Consumer Credit Protection Act* 2009 (Cth), and
 - (c) the credit card contracts were ‘unfair’ within the meaning of s 32W of the FT Act and s 12BG of the ASIC Act.

First instance decision

At first instance, Justice Gordon of the Federal Court held that the provisions requiring customers to make a minimum monthly repayment by the due date stated on each statement or incur a late payment fee (late payment fee provisions) was a penalty at common law. In light of this conclusion, her Honour considered it unnecessary to consider the statutory claims.

Gordon J held none of the other fees charged by ANZ were penalties, and accordingly, these other fees were not considered in subsequent proceedings.

In a 4-1 majority decision in *Paciocco v Australia and New Zealand Banking Group Limited* [2016] HCA 28, the High Court examined a variety of factors called upon by ANZ to justify the late payment fees on the credit card accounts, and found that the fees enforceable as they were not penalties at common law. Additionally, the High Court found that the late payment fee provisions did not amount to unconscionable conduct, or unjust or unfair contract terms under the relevant statutes.

Gordon J held that the late payment fee was a penalty at common law. Her Honour considered the cases:

- (a) *Andrews v Australia and New Zealand Banking Group Ltd* [2012] HCA 30 where it was held that a stipulation prima facie imposes a penalty if it is a collateral stipulation which, upon failure of a primary stipulation, imposes upon one party an additional detriment to the benefit of another party; and
- (b) *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79 (Dunlop) which set out the legal principle that a sum stipulated will be a penalty if it is ‘extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach.’

Ultimately, her Honour held the stipulation for the late payment fees constituted security for, or in terrorem of, the satisfaction of the primary stipulation – that is, that the customers would not breach the contract. Her Honour held the late payment fees charged were extravagant and unconscionable compared to the relevant loss or damage ANZ would have suffered for the late paying customer’s breach, and therefore, the fee charged was a penalty.

In reaching her conclusion, Gordon J accepted evidence from Mr Regan (who was asked about the cost to restore ANZ to the position it would have been in if the particular event giving rise to the entitlement to charge such fees had not occurred) that the only damage that ANZ could be said to have suffered as a result of the late payments was direct costs associated with the recovery of the minimum payment outstanding. The evidence of Mr Inglis (who was asked to calculate the costs that may have been incurred by ANZ in connection with the occurrence of events that gave rise to an entitlement to charge late payment fees) was dismissed because ‘he did not calculate actual loss or damage, but rather, engaged in a broad-ranging exercise of identifying costs that might be affected by late payment, in a more theoretical, accounting, sense.’

Full Court of the Federal Court

The Full Court of the Federal Court of Australia upheld ANZ’s appeal and dismissed Paciocco’s appeal with respect to the various other fees charged by ANZ. The Full Court held it was the evidence of Mr Inglis which should have been considered, and further, that this evidence showed that the late payment fee provisions were not penalties having regard to the legitimate interests of ANZ. In the principal reasons for judgment, Chief Justice Allsop (Besanko and Middleton JJ agreeing) expressed the view that the primary judge had incorrectly ‘undertaken an ex post inquiry of actual damage as a step in assessing whether the prima facie penal character of the late payment fee was rebutted’ and

‘impermissibly narrowed the content of the notion of genuine pre-estimate of damage as a reflex of penalty.’ His Honour held the correct approach was ‘to look at the greatest possible loss on a forward looking basis and to assess that loss by reference to the economic interests to be protected.’

Accordingly, Allsop CJ considered Mr Inglis’ evidence – which, after considering provisioning costs, regulatory capital costs and operational costs, estimated the average costs incurred by ANZ in connection with the occurrence of an event giving rise to an entitlement to charge late payment fees as exceeding \$50 for accounts with higher credit limits and exceeding \$35 for accounts with lower credit limits – as correct. It was held that the late payment fees were not extravagant, exorbitant or unconscionable and accordingly, did not constitute a penalty.

The Full Court held the late payment fees did not fall within any of the statutory claims of unconscionable conduct, unjustness or unfairness. Allsop CJ held that given Paciocco was aware of the fees and charges applicable to his credit card accounts, the fact that it was convenient for the Paciocco to manage his credit card accounts close to their limits, and that Paciocco chose to accept the risk of incurring fees associated with so doing, it was difficult to conclude that ANZ acted unconscionably. The Full Court accepted that the terms were clear, and there was no evidence of undue influence or unfairness.

High Court

The High Court (in a 4-1 majority decision by French CJ and Kiefel, Gageler and Keane JJ, with Nettle J dissenting) agreed with the Full Federal Court and held that the late payment fee was not a penalty and was not prohibited by the relevant statutes. The four separate majority judgements all considered the interests of ANZ, being the party seeking to enforce the contractual provisions, and the range of losses and costs which could be taken into account.

Justice Kiefel noted the principle from *Dunlop* that a sum stipulated for payment on default may be intended to protect an interest that is different from, and greater than, an interest in compensation for loss caused directly by the breach of contract. Kiefel J’s view was that if the test from *Dunlop* applied by Gordon J was understood to mean that ‘only loss in the nature of damages directly flowing from the breach is to be considered’ then the test would be unduly restrictive. Her Honour considered the words ‘extravagant’ and ‘unconscionable’ to describe the ‘plainly excessive nature of the stipulation in comparison with the interest sought to be protected by that stipulation’ and accordingly, was concerned with whether the late payment fees were ‘out of all proportion’ to the interests of ANZ said to be damaged in the event of customer default. In identifying ANZ’s interests, Kiefel J accepted that ANZ’s interests were impacted by late payments in three respects: provisioning costs, regulatory capital costs and operational costs.

Justice Gageler provided a useful description of each of these costs:

- (a) **provisioning costs** capture the expenses which ANZ recognised in its profit and loss account to represent the reductions in the value of customer accounts stemming from a risk of default. As the probability of default increases with late payment, late payments were said to contribute to the overall level of expense ANZ had to recognise in its profit and loss account
- (b) **regulatory capital costs** capture the costs which ANZ incurred as a result of the requirement for it to hold funding capital as a buffer against unexpected losses. As the amount of capital required to be held increases with the probability of default associated with late payment, late payments were said to contribute to the overall level of capital required and the associated costs of funding that capital reserve, and
- (c) **operational costs** capture the costs associated with collection activities, including both the variable or incremental costs of individual collections as well as a proportion of common costs and fixed costs associated with overall collection activities.

Gageler J was primarily concerned with whether,

within the totality of the circumstances within which ANZ contracted with its customer credit card account holders, the stipulation for the payment of the late payment fee was properly characterised as: having no purpose other than to punish an account holder in the event of late payment; or conversely serving the purpose of protecting ANZ's interests in ensuring that customer credit card account holders made the minimum monthly payment by the due date.

In considering the totality of the circumstances, his Honour observed the following circumstances were only weakly indicative of the late fees being a punishment:

- (a) the primary contractual stipulation consisted only in the payment of money, and
- (b) the amount of the late payment fee did not vary according to the amount overdue or the length of delay;

Those circumstances were outweighed by the following circumstances:

- (a) the minimum monthly payment was payable monthly,
- (b) the minimum monthly payment amount was calculated to be a very small percentage of the closing balance of the account,
- (c) the account holder could control the amount of the closing balance by self-regulating the timing and amount of credit card transactions, and
- (d) the account holder could cancel the account at any time.

After considering the totality of the circumstances, Gageler J concluded that the late payment fee provisions were not merely in terrorem or just a punishment, and accordingly, did not constitute a penalty.

Justice Keane acknowledged that:

a bank, like any other party to a contract, has no legitimate interest in punishing its customers for their defaults or in threatening them with punishment in order to discipline their behaviour. But a bank has a multi-faceted interest in the timely performance of its customers' obligations as to payments.

In considering ANZ's legitimate interests, Keane J considered the following:

- (a) other elements of the cost to ANZ to provide the facility to customers, such as interest charged,
- (b) the fact that ANZ assumed the financial risk,
- (c) that timely repayment by customers would allow ANZ to pursue more lending than it would be able to when constrained to take into account the effect of defaulting customers, and
- (d) that if all borrowers made repayments on time, ANZ would have greater freedom from the risks associated with late payments which would enable it to reduce the cost of its facilities to all customers and secure more customers and higher revenues.

As a result of the broad range of legitimate interests that ANZ was entitled to protect through the late payment fee provision, the majority of the High Court held Mr Inglis' evidence which factored in provisioning, regulatory capital and operational costs as the appropriate calculation. Given Mr Inglis estimated that ANZ was entitled to charge late payment fees exceeding \$50 for accounts with higher credit limits and exceeding \$35 for accounts with lower credit limits, the High Court held that ANZ was entitled to charge late payment fees of up to \$35.

The High Court considered the provisions of s 12CB of the ASIC Act, as they were prior to 1 January 2012, which were also relied upon by the customers in this case: 12CB(2)(a) and (b). These provisions provided that when determining whether a supplier of financial services has engaged in unconscionable conduct, a court may have regard to:

- (a) *the relative strengths of the bargaining positions of the supplier and the customer; and*
- (b) *whether, as a result of conduct engaged in by the supplier, the consumer was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the supplier; ...*

The High Court emphasised that the customers were incorrect to only rely on certain subsections of s 12CB(2) and ignore the matters listed in the other subsections – each matter referred to in the subsections was to form part of the totality of the circumstances. Nevertheless, the High Court considered the matters listed in 12CB(a) and (b) and concluded that: in relation to (a) the mere existence of a disparity in bargaining power was not enough to show the party enjoying the superior power acts unconscionably merely by exercising it; and in relation to (b) ANZ did not engage in any relevant conduct as ANZ did not cause Paciocco to enter into credit card contracts or cause him to fail to make the minimum monthly payments – Paciocco chose to do those things.

A similar analysis applied in relation to s 76 of the National Credit Code and s 32W of the FT Act. In relation to s 76(2) of the National Credit Code the High Court confirmed that a conclusion about whether a contract was unjust could only be drawn having regard to all the circumstances of the case, and held that having regard to all these circumstances, the standard contractual stipulation for charging the late payment fees was not unjust. In relation to s 32W of the FT Act, Paciocco argued the late payment fee provisions caused a significant imbalance in the rights and obligations of himself and ANZ because ANZ was in a position where it was able to profit from customers' breaches of contract quid pro quo. Paciocco argued this imbalance was evidenced by the fact that there was no meaningful relationship between the amount of the late payment fee and the reasonably foreseeable loss which would result to ANZ from late payment. Gageler J made two responses to this argument:

- (a) that there was a meaningful relationship between the late payment fee charged and the costs to ANZ, and
- (b) more importantly, even if the late payment fee provisions were characterised as penalising the consumer but not the supplier for a breach of the contract, this imbalance would be only one of the many relevant factors that needed to be taken into account.

Keane J cited with approval Allsop CJ's conclusion from the Full Federal Court proceedings:

Neither the relevant provisions of the [FTA] nor of the National Credit Code exhibit the intention that the Court should assume the role of a price regulator. It is unjustness or unfairness of transactions or terms that is required to be demonstrated. Price may affect such an evaluation but it does not determine it.

Keane J also considered the requirement of s 32W that the term needed be 'to the detriment of the customer' in order to be unfair. His Honour held this element was not satisfied because the late payment fee was not a detriment to Paciocco, rather, it was an expense which Paciocco chose to risk as more convenient to him than paying his account on time.

The takeaway

This decision highlights that participants in the financial services industry, and potentially other industries (e.g. telecommunications, utilities and construction) are not restricted to charging late payment fees which reflect the actual damage incurred by late payments. Rather, they may be justified in charging late payment fees that are not 'out of all proportion' to their legitimate interests and which take into account a broader range of costs.

Whilst this decision provides insight into the relevant principles to be applied in these sorts of cases, it is important to recognise that there were four distinct majority judgments, each with their own nuances on what needs to be considered in determining whether a late payment fee is enforceable.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

Tony O'Malley, Partner
+61 (2) 8266 3015
tony.omally@pwc.com

Murray Deakin, Partner
+61 (2) 8266 2448
murray.deakin@pwc.com

Sylvia Ng, Director
+61 (2) 8266 0338
sylvia.ng@pwc.com