MAY 2015

COMMENTARY

Bank Fees Class Action in Australia Fails Before Full Federal Court

Key Points

- In *Paciocco v Australia and New Zealand Banking Group Limited* ("ANZ") [2015] FCAFC 50, the Full Court of the Federal Court of Australia (the intermediate appeals court in the Federal Court hierarchy) overturned the trial judge's finding that ANZ credit card late payment fees were penalties at law and in equity.
- The Full Court found that the trial judge erred in determining whether the fee was a genuine pre-estimate of the loss through undertaking a comparison between the actual loss arising from the specific transactions and the fee (what the Full Court called an *ex post* analysis) rather than a forward-looking analysis of the greatest loss that ANZ could have incurred at the time the contract was entered into and the fee (an *ex ante* analysis). Further, the Full Court found that the late payment fee was not extravagant and unconscionable and therefore was not a penalty at law or in equity.
- The Full Court otherwise upheld the trial judge's finding that:
  - the other fees imposed by ANZ were not penalties;
  - imposing the fees was not unconscionable conduct or unjust;
  - the provisions of the contract in relation to the fees were not unfair contract terms; and
  - Mr Paciocco's claims were not statute barred.
- Mr Paciocco and Speedy Development Group Pty Ltd ("SDG") (together, the "Applicants" in the primary proceedings) have applied for leave to appeal the judgment to the High Court of Australia (the highest and final appeals court).

Background

The matter first came before Gordon J of the Federal Court in 2014. The matter was brought by Mr Lucio Paciocco and a company controlled by him, SDG. The matter was a representative proceeding under Pt IVA of the *Federal Court of Australia Act 1976* (Cth).

Mr Paciocco held a consumer deposit account and two consumer credit card accounts with ANZ. SDG held a business deposit account. The Applicants sought to set aside bank fees charged by ANZ because the fees:

- were penalties, either at common law or in equity; or

- were the products of unconscionable conduct by ANZ within the meaning of the *Australian Securities and Investments Commission Act 2001* (Cth) (the "ASIC Act"), ss 12CB and 12CC, or the *Fair Trading Act 1999* (Vic) (the "FT Act"), ss 8 and 8A; or
- were unjust under the National Credit Code in Schedule 1 to the *National Consumer Credit Protection Act 2009* (Cth); or
- were charged pursuant to contractual provisions that were unfair contract terms under the FT Act, s 32W and the ASIC Act, s 12BG.

ANZ denied the claims made by Mr Paciocco and SDG and contended that Mr Paciocco and SDG were statute barred from bringing claims in relation to two of the fees because they were debited from the account more than six years prior to the commencement of the proceedings.

Gordon J made the following findings:[1]

- The credit card late payment fees charged by ANZ were penalties at common law and in equity.
- The bank customers were entitled to recover from ANZ the difference between the credit card late payment fees paid to ANZ and ANZ's actual loss.
- The nonpayment fees, overlimit fees, honour fees and dishonour fees were not penalties.
- None of the fees was charged in contravention of various statutory provisions in relation to unconscionable conduct, unjust transactions or unfair contract terms.
- Mr Paciocco's claims were not statute barred.

Both parties appealed Gordon J's decision. ANZ submitted that Gordon J erred in finding that the late payment fee was a penalty and that s 27 of the *Limitation of Actions Act 1958* (Vic) applied to two fees (thereby bringing those claims within time).

Mr Paciocco and SDG contended that Gordon J erred because her Honour did not construe the fees (other than the credit card late payment fee) as penalties and her Honour did not find that there was statutory unconscionability, unjust transactions or unfair contract terms.

The Full Court, which comprised Allsop CJ, Middleton J and Besanko J, overturned Gordon J's finding that the late payment fee was a penalty but otherwise upheld her Honour's judgment.

Were the Bank Fees Penalties?

The legal test pertaining to penalties, as stated by Gordon J in her Honour's primary judgment and confirmed as correct by the Full Court, is as follows:[2]

1 Identify the terms and inherent circumstances of the contract, judged at the time of the making of the contract.

2 Identify the event or transaction which gives rise to the imposition of the stipulation.

3 Identify if the stipulation is payable on breach of a term of the contract (a necessary element at law but not in equity). This necessarily involves consideration of the substance of the term, including whether the term is security for, and *in terrorem* of, the satisfaction of the term.

4 Identify if the stipulation, as a matter of substance, is collateral (or accessory) to a primary stipulation in favour of one contracting party and the collateral stipulation, upon failure of the primary stipulation, imposes upon the other contracting party an additional detriment in the nature of a security for, and *in terrorem* of, the satisfaction of the primary stipulation.

5 If the answer to either question 3 or 4 is "yes," then further questions arise (at law and in equity), including:
   - 5.1 Is the sum stipulated a genuine pre-estimate of damage?
   - 5.2 Is the sum stipulated extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved?
   - 5.3 Is the stipulation payable on the occurrence of one or more or all of several events of varying seriousness?

   These questions are necessarily interrelated.

6 If 5 has been satisfied, then the stipulation is unenforceable to the extent that the stipulation exceeded that amount. Put another way, the party harmed by the breach or the failure of the primary stipulation may enforce the stipulation only to the extent of that party's proved loss.

Late Payment Fee. In relation to the late payment fee, ANZ's key submission was that Gordon J, having correctly stated the law in relation to penalties, failed to apply the material before her Honour. According to ANZ, the correct approach to applying step 5 of the legal test (in particular step 5.2) was founded upon the need to show, by an ex ante (i.e., forward-looking)

analysis at the time of entry into the contract, that the stipulation was extravagant and unconscionable in comparison to the greatest loss that could conceivably be proven to follow from such a breach. It was submitted that the primary judge undertook an ex post analysis or assessment of the actual loss arising from the breaches by Mr Paciocco and SDG.

The Full Court accepted ANZ's submission on this point and found that Gordon J had essentially conflated steps 5 and 6 by taking an *ex post* analysis of actual loss in determining whether the fee was penal in character. Allsop CJ explained that step 5 and 6 are concerned with different enquiries—step 5 of the test is intended to be determinative of whether the stipulation is penal in character, whereas step 6 is concerned with the damages available to the party harmed. As such, step 5 looks forward and is referrable to the time of entry into the contract and the legitimate interest of the obligee in the performance of the relevant provision of the contract. Step 6 looks backward to see what damage has been demonstrated to have been caused by the breach or failure of the relevant provision.

A corollary of the Full Court accepting ANZ's submission that step 5 requires an *ex ante* analysis was the Full Court's finding that Gordon J incorrectly placed weight on the fact that ANZ had not undertaken a genuine pre-estimation of the damages when it entered into the contract. The Full Court held that the absence of such conduct does not mean that the fee in question was a penalty. However, Allsop CJ noted that, contrary to the fact, had ANZ conducted a bona fide assessment of the loss if the customer breached the term, then it would have gone some way to a conclusion that the character of the provision was not penal and therefore was a genuine pre-estimate of damages.

A further related submission made by ANZ was that the trial judge erred in accepting Mr Paciocco's and SDG's expert's evidence in relation to the unconscionability and extravagance of the fee. It was accepted by the primary judge (and the parties) that the assessment of extravagance, exorbitance and unconscionability is an essential element of the penal character and that such an assessment must be done at the time of entry into the contract. The Full Court found that Mr Paciocco's and SDG's expert, Mr Regan, was retained only to consider step 6 of the test—quantifying the bank's actual loss so as to determine the amount to be repaid to the customer. Mr Paciocco and SDG (who hold the burden of proof in relation to proving that the fee was exorbitant and extravagant at the time of entering into the contract) submitted that the evidence of Mr Regan was also relevant to the question of examination of exorbitance and extravagance prospectively. This approach was adopted by the primary judge.

The Full Court found that Mr Regan did not attempt to look forward to assess what conceivably could be the damage from some (but not this particular) breach of the contract, and therefore one cannot take from Mr Regan's evidence that the amount was extravagant or exorbitant by reference to the greatest conceivable loss that might be caused by a breach of the term in question. Further, the Full Court stated that the primary judge was wrong to criticise ANZ's expert, Mr Inglis, for taking a prospective inquiry as to ANZ's greatest conceivable loss in his evidence in relation to step 5 that the fees were not extravagant or exorbitant.

Other Fees. Mr Paciocco and SDG appealed on the basis that Gordon J erred in finding that the other fees were not penalties. The Full Court upheld Gordon J's findings.

Unconscionability, Unjust Terms and Unfair Terms

Mr Paciocco and SDG contended that Gordon J wrongly found that imposing the fees was not unconscionable conduct or unjust and the provisions of the contract in relation to the fees were not unfair.

In relation to statutory unconscionability, the gravamen of the attack was the asserted failure to take into account what was said to be the huge disparity between the level of the fees and the costs ANZ sustained by the exception fee events. Allsop CJ noted that the submission was put in "rich language of illusory services, price gouging, monopolistic price setting and cartel-type price fixing, and unethical overcharging. Much of the language was not supported, or even informed, by the evidence of the case".[3]

Further, Allsop CJ noted that the fact that the primary judge concluded that the fees were in excess of the damages caused by the breaches by the Applicants did not make that analysis

universally relevant in relation to statutory unconscionability. Rather, the question of whether the conduct of ANZ was unconscionable should take into account the perspective of all of the circumstances of the case. The Full Court stated that Mr Paciocco did not demonstrate, from a reasonable perspective of all of the circumstances, that the fees were unconscionable.

The Full Court found that ANZ's conduct did not have the values of unconscionable conduct:[4]

> There was no dishonesty; there was no trickery or sharp practice; the fees were fully and not unfairly disclosed; the applicants were not vulnerable, nor were customers generally; the fees could be avoided by the customer; these applicants chose to run their affairs by risking the fees; there was no victimisation, predation or taking advantage of the applicants, or, on the evidence, of anyone; the bargaining power to set the terms was real, but the customer was not forced to deal with the bank or to incur the fees; there was no lack of good faith by ANZ.

The Full Court concluded that to find that ANZ's conduct was unconscionable would "require the court to be a price regulator in banking business in connection with otherwise honestly carried on business in which high fees were extracted from customers".[5]

Middleton J (who agreed with Allsop CJ's reasons) noted the need for courts in reaching an ultimate determination of whether there had been statutory unconscionable conduct to undertake the familiar tasks of evaluating the facts and engaging in statutory construction consistent with established principles. Middleton J contrasted this with the undesirable situation of a judge imposing his or her perceptions of desirable social goals. His Honour went on to contrast the role of the legislature, which enacts legislation to give effect to policy decisions about desirable standards of commercial behaviour, and the court, which applies those standards to specific factual scenarios that come before it.

Additionally, the Full Court rejected the submission by Mr Paciocco and SDG that there was any unfairness or unjustness in the fees. The court noted that although it can be accepted that unjustness and unfairness are of a lower moral or ethical standard than unconscionability, the court's analysis in relation to unconscionability would also justify a conclusion that there was a lack of unjustness or unfairness.

Statute of Limitations

While the Full Court was not required to consider the statute of limitations argument in light of the finding in favour of ANZ, Besanko J nonetheless considered ANZ's contention that s 27 of the *Limitations of Action Act 1958* (Vic) does not apply to claims in relation to two of the fees.

Section 27 states that if there is a mistake then the period of limitation shall not begin to run until the plaintiff has discovered the mistake or could with reasonable diligence have discovered it.

The Full Court upheld the primary judge's conclusion as the words of s 27(c) are quite general and are capable of being given an ambulatory effect so that it applies to both a mistake of fact and a mistake of law.

Ramifications

The immediate effect of the Full Court's judgment is to bring to a halt a number of pending and threatened class actions against banks and other corporations based on their fees being a penalty. However, before the novel idea of using the penalties doctrine to found consumer class actions can be said to be dead, it is necessary to wait and see if the High Court of Australia grants special leave to appeal. Of note is that days after the Full Court's judgment was handed down, the Attorney General of Australia announced the appointment of the primary judge, Gordon J, to the High Court of Australia. Her Honour will be sworn in on 9 June 2015 but will not sit on any appeal of *Paciocco v ANZ* to the High Court.

Based on the above reasoning, the Full Court's decision provides the following lessons:

- For liquidated damages clauses or clauses that provide for a fee if there is a breach of another term, the amount charged must be an amount that would be a genuine pre-estimation of loss, and it must not be exorbitant or unconscionable.
- If a party did not, in fact, undertake the exercise of deciding whether the liquidated damages clause is a genuine pre-estimation of loss when entering into the contract,

then this will not mean that the liquidated damage clause is penal (although if the exercise is undertaken, it may be helpful in proving that it is not penal).

- When giving instructions to expert witnesses, it is important they receive the correct instructions as to the scope of their inquiries; in this case, it was fatal that Mr Regan was asked only to consider the actual loss arising out of the breaches of the contracts as that was not relevant to the test as to whether the fees were penal.
- Fees that are higher than the loss incurred will not lead to a conclusion that imposition of those fees is unconscionable, unfair or unjust; other factors must be present to make such a conclusion.
- Mistakes of law may be a basis for contending that the limitation period runs from the date that the mistake of law was discovered or could with reasonable diligence have been discovered. This creates a risk that transactions considered final and settled might be challenged many years after they have taken place on the basis of mistake of law, possibly revealed by a subsequent judicial decision (which reverses an earlier authority).

Lawyer Contacts

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Endnotes

1 See *Jones Day Commentary*, "Bank Fees Class Actions in Australia: Customers Recover Credit Card Late Payment Fees That Exceeded Bank's Costs" (February 2014).

2 *Paciocco v Australia and New Zealand Banking Group Limited* [2015] FCAFC 50, [26] and [19] – [28]; *Paciocco v Australia and New Zealand Banking Group Limited* [2014] FCA 35, [15] and [13] – [48] citing *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205; *Dunlop Pneumatic Tyre Company Ltd v New Garage and Moto Co Ltd* [1915] AC 79; *AMEV-UDC Finance Ltd v Austin* (1986) 162 CLR 170.

3 *Paciocco v Australia and New Zealand Banking Group Limited* [2015] FCAFC 50, [330].

4 *Ibid*, [336].

5 *Ibid*, [347].