

Legal update - New Australian guidance on penalties

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Last week the High Court of Australia in *Paciocco v Australia and New Zealand Banking Group Limited (ANZ)* [2016] HCA 28 dismissed the appeal in relation to credit card late payment fees charged by ANZ.

This is the latest chapter in the long-running class action challenging bank fees in Australia but the case has much broader significance as the penalties doctrine can apply to a wide range of common clauses in all sorts of commercial contracts, from provisions requiring the payment of liquidated damages triggered by a delay in meeting milestones (common in ICT and construction contracts) through to provisions requiring the transfer of shares at a reduced price in circumstances where a vendor fails to comply with a non-compete restriction in a sale and purchase agreement.

The decision of the High Court follows a Federal Court of Australia decision last year that overturned the first instance decision which held that credit card late payment fees charged by ANZ were penalties. In that decision, the Federal Court held that the fees were not penalties as the test as to whether a fee is extravagant or unconscionable must be assessed by reference to the greatest loss that could flow from non-payment, rather than the actual damage resulting from breach.

At High Court level, the 4-1 majority agreed with the Federal Court's analysis and held that the loss suffered by ANZ must be assessed by reference to all interests affected by late payment of outstanding credit card balances, namely: increased provision for bad or doubtful debts, regulatory capital costs, and the costs of collecting outstanding amounts owed by customers.

Furthermore, the High Court confirmed that the late payment fees were not penal even though there was no genuine pre-estimate of potential loss made by ANZ at the time the contracts with customers were entered into. The late fees were enforceable as they were not out of all proportion to ANZ's interests in receiving timely payment of outstanding credit card balances and were not unjust, unfair, or a result of ANZ engaging in unconscionable conduct.

The High Court's decision is particularly significant as the majority held that the relevant loss, when assessing whether a clause is penal, is not merely the damages recoverable as a result of a breach of contract. Rather, the scope of loss that can be considered is much wider, allowing contracting parties to protect against interests greater than the damages that could be recovered directly from a contracting party's breach.

Both the High Court of Australia decision and the UK Supreme Court decision of *Cavendish v Makdessi* [2015] UKSC 67 demonstrate that payments due under a contract are unlikely to be unenforceable penalties unless the payments are out of all proportion to the interests they seek to protect. That proposition may be tested shortly, in the New Zealand equivalent of the Australian bank fees litigation, which media reports suggest may still go ahead.

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