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PACIOCCO v AUSTRALIA & NEW ZEALAND BANKING GROUP LTD (2016) 90 ALJR 835

I Introduction

The highly anticipated conclusion to a five-year battle over the status of the doctrine of penalties in Australia came in the case of *Paciocco v Australia & New Zealand Banking Group Ltd*.[1] This case note reviews the procedural history of *Paciocco*, which provides the foundation for the earlier controversy surrounding the penalties doctrine and the consequent importance of the case, before undertaking an analysis of the High Court's decision and its wider ramifications. *Paciocco* takes a welcome step towards remedying the Court's prior significant expansion of the doctrine.

II Background

A *Andrews v Australia and New Zealand Banking Group Ltd*

Paciocco was characterised as the 'sequel'[2] to the case of *Andrews v Australia and New Zealand Banking Group Ltd*,[3] in which the High Court reconsidered the application of the penalties doctrine in Australia. The *Andrews* litigation commenced before Gordon J in the Federal Court in 2011, and constituted representative proceedings against Australia and New Zealand Banking Group Ltd ('ANZ') to obtain declarations that 'exception fees' charged on accounts amounted to penalties and were therefore unenforceable.[4] Justice Gordon held that, of the various exception fees, only the late payment fees could be considered penalties.[5] The decision was appealed to the Full Court of the Federal Court, however, the High Court removed the issues arising in the appeal relating to the penalties doctrine.[6]

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1 (2016) 90 ALJR 835 ('*Paciocco*').

2 Ibid 852 [72] (Gageler J).

3 (2012) 247 CLR 205 ('*Andrews*').

4 *Andrews v Australia and New Zealand Banking Group Ltd* (2011) 211 FCR 53, 59 [1].

5 Ibid 60 [5].

6 *Andrews* (2012) 247 CLR 205, 219 [17]–[18] (French CJ, Gummow, Crennan, Kiefel and Bell JJ).

A unanimous High Court reconfigured the doctrine of penalties and its application in Australia. The Court defined a penalty as a 'collateral' stipulation imposing 'upon the failure of the primary stipulation … an additional detriment … in the nature of a security for and *in terrorem* of the satisfaction of the primary stipulation'.[7] Significantly, the Court, explicitly overruling *Interstar Wholesale Finance Pty Ltd v Integral Home Loans Pty Ltd*,[8] rejected the notion that the application of the penalties doctrine was limited to instances where there had been a breach of contract, as well as the notion that the doctrine was found at common law and not in equity.[9]

The decision of the High Court in *Andrews*, which effectively broadened the scope of the penalties doctrine beyond that expounded in the seminal case of *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd*[10] and endorsed by the High Court in *Ringrow Pty Ltd v BP Australia Pty Ltd*,[11] was widely criticised. As French CJ and Gageler J noted in *Paciocco*,[12] the UK Supreme Court recently deemed *Andrews* 'a radical departure from the previous understanding of the law'.[13] In a practical context, the decision in *Andrews* was taken as demanding the reconsideration of contracts in a variety of industries, which could now be caught by the expanded scope of the doctrine.[14] Commentators criticised the High Court's 'complex and convoluted' penalty definition, which fostered uncertainty in contractual drafting,[15] and the lack of consideration given to contemporary and contrary authority.[16]

However, the High Court did not decide whether the exception fees in question constituted penalties in *Andrews*, and remitted the case to Gordon J in the Federal Court. This formed the basis of the *Paciocco* litigation.

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7 Ibid 216 [10].

8 (2008) 257 ALR 292.

9 *Andrews* (2012) 248 CLR 205, 227 [46], 228 [50], 233 [63], 236 [78] (French CJ, Gummow, Crennan, Kiefel and Bell JJ).

10 [1915] AC 79 ('*Dunlop*').

11 (2005) 224 CLR 656 ('*Ringrow*').

12 (2016) 90 ALJR 835, 841 [7] (French CJ), 857 [121] (Gageler J).

13 *Cavendish Square Holding BV v Talal El Makdessi* [2016] 2 All ER 519, 541 [41] (Lord Neuberger and Lord Sumption) ('*Cavendish*').

14 See, eg, Steven Klimt and Narelle Smythe, *When Is a Penalty Clause Not a Penalty Clause?* (18 September 2012) Clayton Utz <https://www.claytonutz.com/knowledge/2012/september/when-is-a-penalty-clause-not-a-penalty-clause>.

15 See, eg, J W Carter et al, 'Contractual Penalties: Resurrecting the Equitable Jurisdiction' (2013) 30 *Journal of Contract Law* 99, 103, 112.

16 See generally ibid.

B *Facts*

The first appellant, Mr Paciocco, and the second appellant, Speedy Development Group Pty Ltd, held credit card and deposit accounts with the respondent, ANZ.[17] These accounts were charged numerous 'exception fees', in accordance with ANZ's standard terms and conditions for the accounts, and included 'late payment fees'.[18] These were fees charged for failing to meet the minimum monthly payment by the due date. The late payment fee applied equally to accounts irrespective of the outstanding payment amount. Mr Paciocco argued that these late payment fees constituted penalties and were therefore unenforceable, and in the alternative, that they were in contravention of various statutory provisions.[19]

Mr Paciocco brought the action against ANZ as a representative proceeding.[20] Other class actions brought on similar grounds against other major banks in Australia were stayed pending the outcome of the *Paciocco* litigation.[21]

C *Procedural History*

1 *Primary Judgment*

At first instance, Gordon J set out a six-step test[22] that effectively combined the formulations in *Dunlop*, *AMEV-UDC Finance Ltd v Austin*[23] and *Andrews* and, applying this test, concluded that of the exception fees, only the late payment fees constituted penalties.[24] Her Honour held that the late payment fees were to be paid

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17 As the second appellant is a company controlled by the first appellant, subsequent references to Mr Paciocco will be taken to include the second appellant: *Paciocco* (2016) ALJR 835, 839 [2] (French CJ).

18 *Paciocco* (2016) 90 ALJR 835, 853 [82] (Gageler J).

19 *Australian Securities and Investments Commission Act 2001* (Cth) ss 12BG, 12CB and 12CC; *National Consumer Credit Protection Act 2009* (Cth) sch 1, s 76; *Fair Trading Act 1999* (Vic) ss 8, 8A and 32W.

20 *Federal Court of Australia Act 1976* (Cth) pt IVA.

21 The stayed class actions were against the remainder of the 'Big Four' (Commonwealth Bank of Australia, Westpac Banking Corporation and National Australia Bank) as well as Citibank, St. George Bank, BankSA and Bankwest: Maurice Blackburn Lawyers, *Bank Fees Class Action* <https://www.mauriceblackburn.com.au/past-class-actions/bank-fees-class-action/>; Rachael Brown, 'ANZ Class Action: Bank Wins Appeal Against Credit Card Fees Decision', *ABC News* (online), 8 April 2015 <http://www.abc.net.au/news/2015-04-08/anz-bank-wins-appeal-against-credit-card-fees-decision/6376834>.

22 *Paciocco v Australia and New Zealand Banking Group Ltd* (2014) 309 ALR 249, 258 [15] (Gordon J).

23 (1986) 162 CLR 170 ('*AMEV-UDC*').

24 *Paciocco v Australia and New Zealand Banking Group Ltd* (2014) 309 ALR 249, 326–7 [373]–[374].

upon breach of the contract (a requirement at law only and not in equity)[25] and, alternatively, that they were collateral to a primary stipulation in ANZ's favour in accordance with the High Court's penalty definition in *Andrews*.[26]

The conclusion of Gordon J turned on the evidence of two expert witnesses: Mr Regan for Mr Paciocco and Mr Inglis for ANZ. Mr Regan and Mr Inglis both gave evidence on the costs incurred by ANZ as a result of late payments. However, Mr Paciocco instructed Mr Regan to calculate the actual loss sustained by ANZ from the late payments and the cost of returning ANZ to its original position ('operational costs'), whereas ANZ instructed Mr Inglis to calculate the maximum amount of costs conceivably incurred by ANZ from the late payments (which included, in addition to operational costs, the cost of increases in loss provisions and the cost of regulatory capital). As a result, the figure asserted by Mr Inglis was significantly higher than that of Mr Regan. Justice Gordon preferred Mr Regan's evidence and rejected that of Mr Inglis, which her Honour considered calculated costs too broadly 'in a theoretical accounting sense' instead of the actual loss or damage that was relevant for the purposes of the test.[27] Her Honour accordingly concluded that the late payment fees were 'extravagant and unconscionable'.[28]

2 *Appeal to the Full Court of the Federal Court*

ANZ appealed the finding at first instance that the late payment fees constituted penalties,[29] while Mr Paciocco appealed the finding that the other exception fees were not penalties.[30] The Full Court of the Federal Court (Allsop CJ delivering the lead judgment with Besanko and Middleton JJ agreeing) allowed ANZ's appeal and dismissed Mr Paciocco's appeal.[31]

In contrast to the primary judge, Allsop CJ held that the approach of Mr Inglis was correct.[32] Applying 'the correct analytical perspective', the late payment fees could not be considered extravagant or unconscionable.[33] ANZ argued that Gordon J had erred by undertaking an *ex post* assessment of the actual damage suffered from breach, in circumstances where an *ex ante* assessment of the greatest conceivable loss as well as the 'economic interests to be protected'[34] was required to determine whether a stipulation is extravagant or unconscionable, and therefore a penalty.

25 Ibid 258 [15].

26 Ibid 326 [373].

27 Ibid 284 [140].

28 Ibid 302 [240].

29 *Paciocco v Australia and New Zealand Banking Group Ltd* (2015) 236 FCR 199, 231 [81] (Allsop CJ).

30 Ibid 252 [194].

31 Ibid 288 [367] (Allsop CJ), 289 [371] (Besanko J), 295 [398] (Middleton J).

32 Ibid 251 [184].

33 Ibid 251 [187].

34 Ibid 247 [169].

Chief Justice Allsop accepted this submission.[35] His Honour held that the other costs taken into account by Mr Inglis — provisioning and regulatory capital costs — were legitimate interests of ANZ that merited protection.[36]

III Decision

Mr Paciocco raised two grounds of appeal to the High Court. The first ground of appeal concerned the issue of whether the late payment fees amounted to penalties. The second ground of appeal related to the claims that the late payment fees breached the aforementioned statutory provisions. The following analysis of the Court's decision will deal with the first ground of appeal, which has proved the most contentious aspect of this decision and the preceding litigation over the last five years. The Court (4:1) dismissed the appeal and agreed with the Full Court of the Federal Court, finding that the late payment fees were not penalties.

A *The Test*

Justice Kiefel, French CJ agreeing,[37] held that the relevant question to determine what would amount to a penalty was 'whether a provision for the payment of a sum of money on default is out of all proportion to the interests of the party which it is the purpose of the provision to protect.'[38] Her Honour considered that such a test was consistent with the cases of *Clydebank Engineering & Shipbuilding Co Ltd v Castaneda*,[39] *Dunlop*, *Ringrow* and *Andrews*.[40]

Applying *Cavendish*, Keane J held that where 'the sum or remedy stipulated as a consequence of a breach of contract is exorbitant or unconscionable when regard is had to the innocent party's interest in the performance of the contract', the stipulation would amount to a penalty as opposed to a 'provision protective of a legitimate interest'.[41] This formulation is very similar to that advocated by Kiefel J. In *Ringrow*, the High Court interpreted 'extravagant and unconscionable' as meaning 'out of all proportion'.[42] The critical difference is the requirement that the stipulation be triggered by a breach of contract — the element on which *Cavendish* and *Andrews*, and accordingly UK and Australian law, diverge.

35 Ibid 237 [117], 242 [147].

36 Ibid 246 [164], 247 [167].

37 *Paciocco* (2016) 90 ALJR 835, 840 [2].

38 Ibid 846 [29]. See also ibid 850 [57] and 851 [69].

39 [1905] AC 6 (an antecedent of *Dunlop*).

40 *Paciocco* (2016) 90 ALJR 835, 851 [69] (Kiefel J).

41 Ibid 882 [270], quoting *Cavendish* [2016] 2 All ER 519, 608 [255] (Lord Hodge).

42 *Ringrow* (2005) 224 CLR 656, 669 [32] (Gleeson CJ, Gummow, Kirby, Hayne, Callinan and Heydon JJ).

Justice Nettle, the sole dissentient, distinguished between what he considered to be a 'typical penalty case' — as referred to by the High Court in *Ringrow*[43] and to which the *Dunlop* tests would be applicable — and the 'more complex' penalty case referred to in *Cavendish*, which would require considerations 'beyond a comparison of the agreed sum and the amount of recoverable damages', including the legitimate interests of the party allegedly imposing the penalty.[44] In the case of the former, the test would be whether the stipulation was 'exorbitant or extravagant (or, in other words, "out of all proportion") in comparison with the greatest loss that could conceivably be proved to have followed from the breach'.[45] In the case of the latter, the test would be that expressed in *Cavendish* and applied by Keane J above.[46]

Although these judges differed in their articulation of the applicable test, their Honours were in agreement regarding the key aspect of a penalty: it must be exorbitant or out of all proportion. That the inquiry necessitated the identification of the party's legitimate interests was also common to the formulations of the judges. However, contrary to Kiefel and Keane JJ, Nettle J held that the inquiry only becomes necessary in complex cases.[47] These conflicting views appear to have arisen from different interpretations of *Ringrow*. According to Nettle J, in 'typical penalty cases', only the amount 'recoverable as unliquidated damages' is relevant.[48] However, Keane J contended that the description in *Ringrow* of 'a genuine pre-estimate of *the damage*', as opposed to damages, included legitimate interests.[49] His Honour's argument that this interpretation is necessary given that these stipulations seek to avoid 'the uncertainty and expense of litigation' is an important practical consideration.[50]

Justice Gageler, on the other hand, framed the inquiry as whether the relevant stipulation 'is properly characterised as having no purpose other than to punish'.[51] His Honour saw this as consistent with the second proposition in *Dunlop* that the 'essence' of a penalty is that it is 'stipulated as *in terrorem*',[52] which he considered 'captures the essence of the conception to which the whole of the analysis is directed'.[53] Justice Gageler preferred such an approach over a formulation requiring considerations of 'legitimate interests', as applied in *Cavendish* and by Keane J, as it allowed

43 Ibid 665 [21].

44 *Paciocco* (2016) 90 ALJR 835, 890–1 [319]–[322].

45 Ibid 894 [338] (citations omitted).

46 Ibid 891 [321]–[322].

47 Ibid 890–1 [319]–[322].

48 Ibid 891 [320], quoting *Ringrow* (2005) 224 CLR 656, 665 [21] (Gleeson CJ, Gummow, Kirby, Hayne, Callinan and Heydon JJ).

49 *Paciocco* (2016) 90 ALJR 835, 884 [282]–[283], quoting *Ringrow* (2005) 224 CLR 656, 662 [10] (Gleeson CJ, Gummow, Kirby, Hayne, Callinan and Heydon JJ) (emphasis added).

50 *Paciocco* (2016) 90 ALJR 835, 884 [284] (Keane J).

51 Ibid 865 [165]–[167].

52 Ibid 864 [158], quoting *Dunlop* [1915] AC 79, 86 (Lord Dunedin).

53 *Paciocco* (2016) 90 ALJR 835, 865 [165] (Gageler J).

for a 'more tailored' consideration of the commercial circumstances surrounding the formation of the contract.[54] His Honour did acknowledge, however, that even such 'differently framed inquiries' could ultimately produce the same outcome[55] — as they did in the present case. A stipulation that is exorbitant or out of all proportion is likely to be considered as having no other purpose than a punitive one. Further, as will be illustrated in the following section, a consideration of interests, as Gageler J himself undertook, also permits the Court to undertake a broad examination of commercial circumstances.

B *Applying the Test*

Justices Kiefel, Gageler and Keane all identified ANZ's 'multi-faceted' commercial interest as ensuring its customers made repayments on time.[56] Justice Keane identified a further interest that derived from this commercial interest: the ability of ANZ to secure greater profit by lending.[57] A consideration of only the operational costs (Mr Regan's evidence) did not adequately reflect the 'totality'[58] or 'full range'[59] of ANZ's interests. The provisioning and regulatory capital costs also affected ANZ's interests by impacting upon recorded profit and outgoings respectively,[60] and were real 'injuries to [ANZ's] financial position' for which ANZ was required to account.[61] Therefore, it could not be said that the late payment fees were out of all proportion to ANZ's interests[62] or stipulated *in terrorem*.[63] Even if, as Gordon J had found, the provisioning and regulatory capital costs as calculated by Mr Inglis were not recoverable in a claim for damages, the test was not restricted to that consideration.[64]

In dissent, Nettle J agreed with the approach undertaken by Gordon J. His Honour found that ANZ's only interest was in obtaining the costs it had actually incurred and were claimable in damages,[65] and therefore the tests in *Dunlop* applied.[66] Justice Nettle analysed each category of costs and concluded that because the provisioning and regulatory capital costs were only an estimate of future loss and had not actually been incurred by ANZ, they could not sound in damages, and were therefore

54 Ibid 865 [166].

55 Ibid.

56 Ibid 850 [58] (Kiefel J), 865 [167], 866 [170]–[172] (Gageler J), 882 [271] (Keane J).

57 Ibid 883 [278].

58 Ibid 866 [170] (Gageler J).

59 Ibid 884 [279] (Keane J).

60 Ibid 866 [172] (Gageler J).

61 Ibid 851 [68] (Kiefel J).

62 Ibid 851 [69] (Kiefel J), 884 [279] (Keane J).

63 Ibid 867 [176] (Gageler J).

64 Ibid 851 [65]–[66] (Kiefel J), 866 [171]–[172] (Gageler J), 884 [282]–[283] (Keane J).

65 Ibid 892 [326] (Nettle J).

66 Ibid 893 [334].

irrelevant to determining whether the late payment fees were penalties.[67] Only the operational costs could be considered, and as these were relatively small, the late payment fees were extravagant or out of all proportion to the greatest conceivable loss that could be claimed in damages.[68]

IV Ramifications

As exemplified by *Paciocco*, a decision on the penalties doctrine has the potential to impact not only upon contracts between commercial parties but also upon the general community. Furthermore, businesses in a wide variety of industries charge late payment fees — telecommunications and utilities are the most prominent among the public.[69] The ramifications of the decision in *Paciocco* are therefore wide-reaching.

In *Andrews*, the High Court broadened the scope of the penalties doctrine by rejecting the requirement that the offending party breach the contract. By endorsing a test that considers the 'legitimate interests' of the party alleged to have imposed a penalty beyond what it is actually capable of recovering in damages, the High Court has made it easier to argue that a stipulation is not out of all proportion to the interests it seeks to protect. The Court took a broad approach to identifying ANZ's interests in *Paciocco*, which, as Gordon J recognised, were merely 'part of the costs of running a bank in Australia'.[70]

The High Court has thereby effectively narrowed the scope of the doctrine significantly — a welcome and appropriate change to the law following the decision in *Andrews*. The penalties doctrine has been deemed an 'anomaly' in the law of contract,[71] and in *Cavendish* the UK Supreme Court took the further step of considering whether it should be abolished altogether.[72] This is further made evident through a comparison of the High Court's position on the relationship between the doctrine of

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67 Ibid 896 [352], 898 [364].

68 Ibid 899 [371].

69 ACA Lawyers was accepting registrations for class actions against Telstra, Optus and Vodafone pending the decision of the High Court in *Paciocco* and was also considering pursuing actions against AGL, EnergyAustralia and Origin, but ceased after the decision in *Paciocco* was handed down: ACA Lawyers, *Telco Class Action* <http://www.acalawyers.com.au/telcos/>; John Rolfe, 'Energy Companies Headed to Court: ACA Lawyers Plan Class Action Against AGL, EnergyAustralia and Origin Over Late Fees', *news.com.au* (online), 20 August 2014 <http://www.news.com.au/>.

70 *Paciocco v Australia and New Zealand Banking Group Ltd* (2014) 309 ALR 249, 287 [155].

71 Anthony Gray, 'Contractual Penalties in Australian Law after *Andrews*: An Opportunity Missed' (2013) 18 *Deakin Law Review* 1, 1.

72 While acknowledging that there was a 'case to be made', the Court ultimately decided against doing so: *Cavendish* [2016] 2 All ER 519, 539–40 [36]–[39] (Lord Neuberger and Lord Sumption), 582–4 [162]–[167] (Lord Mance), 608–10 [256]–[266] (Lord Hodge).

penalties and freedom of contract in *Andrews* against *Paciocco*. Justice Gordon aptly characterised the penalties doctrine as a 'narrow exception' to freedom of contract.[73] However, in *Andrews*, the High Court was not convinced that 'notions of an untrammelled "freedom of contract" provide a universal legal value'.[74] In *Paciocco*, Keane J appears to resile from, or at least qualify, this position by highlighting the 'abiding importance' of the fundamental principle of freedom of contract, and in turn commercial certainty, as limiting judicial intervention in bargains between capable parties.[75] This accords with prior statements of the Court.[76]

Of course, freedom of contract must be balanced against protecting vulnerable or inexperienced parties, and the penalties doctrine plays a role in this.[77] In *Cavendish*, Lord Mance deemed 'the extent to which the parties were negotiating at arm's length on the basis of legal advice' a 'relevant factor' in determining the exorbitance of the stipulation.[78] However, in *Paciocco*, only Nettle J in dissent had regard to the nature of the relationship between ANZ and Mr Paciocco, and the inherent incapacity of Mr Paciocco as a consumer to negotiate a standard form contract with a commercial party such as ANZ in arriving at his conclusion.[79] The relevance of such a consideration to the penalty test, and whether the test would apply differently, for example, to a commercial construction contract, warranted closer examination by the majority.

V Conclusion

The aforementioned wide-reaching ramifications of the High Court's decision indicate that the significance of *Paciocco* cannot be underestimated. The Court's clarification of the requisite test, the narrowing of the penalties doctrine and the revival of freedom of contract subsequent to *Andrews* is laudable. However, in bringing an end to the bank fees saga, *Paciocco* leaves unanswered a number of questions concerning the doctrine of penalties that arose from the High Court's decision in *Andrews*. Commentators will continue to grapple with the nature of the relationship of the penalties doctrine at law and in equity,[80] how penalties can be partially

73 *Andrews v Australia and New Zealand Banking Group Ltd* (2011) 211 FCR 53, 60 [4].

74 *Andrews* (2012) 247 CLR 205, 216 [5] (French CJ, Gummow, Crennan, Kiefel and Bell JJ).

75 *Paciocco* (2016) 90 ALJR 835, 872–3 [220]–[221], 878 [250]–[251]. See also 849 [54] (Kiefel J), 863 [156] (Gageler J), quoting *Ringrow* (2005) 224 CLR 656, 669 [31]–[32] (Gleeson CJ, Gummow, Kirby, Hayne, Callinan and Heydon JJ).

76 *Ringrow* (2005) 224 CLR 656, 669 [31]–[32] (Gleeson CJ, Gummow, Kirby, Hayne, Callinan and Heydon JJ); *AMEV-UDC* (1986) 162 CLR 170, 190, 193–4 (Mason and Wilson JJ).

77 *AMEV-UDC* (1986) 162 CLR 170, 194 (Mason and Wilson JJ).

78 *Cavendish* [2016] 2 All ER 519, 579 [152].

79 *Paciocco* (2016) 90 ALJR 835, 899 [371].

80 Justice Gordon's aforementioned six-step test, approach and alternative conclusions in *Paciocco v Australia and New Zealand Banking Group Ltd* (2014) 309 ALR 249 appear to suggest that they are separate.

enforced,[81] the concept of 'collateral stipulations',[82] which did not feature in the formulations of the judges in *Paciocco*, and the application of the test to contracts between experienced commercial parties. The resolution of these issues now falls to future cases.

81 According to the Court's penalty definition in *Andrews*, 'the collateral stipulation and the penalty are enforced *only to the extent*' of compensation made to the party benefitting from the penalty for 'prejudice suffered by failure of the primary stipulation': *Andrews* (2012) 247 CLR 205, 216–17 [10] (French CJ, Gummow, Crennan, Kiefel and Bell JJ) (emphasis added). See, eg, discussion in Carter et al, above n 15, 114–17. The concept of partial enforcement was also criticised in *Cavendish* [2016] 2 All ER 519, 553–4 [85]–[87] (Lord Neuberger and Lord Sumption).

82 See, eg, Carter et al, above n 15, 117–21.