A six year legal battle came to an end yesterday when the High Court ruled in favour of ANZ Bank, finding by a 4-1 majority that the bank could enforce late payment fees on credit cards.

The lead plaintiff in the class action was Mr Paciocco, who opened two MasterCard accounts with the bank. One card had a credit limit of A$18,000 the other had a A$4,000 limit.

Mr Paciocco was late in meeting his monthly repayments on a number of occasions, and was required to pay late payment fees. The fee was initially $35, with the bank later reducing it to $20. Mr Paciocco was not the only ANZ customer who was late in repaying their credit card debts. During the financial year ended September 2009 the bank had around two million consumer credit card accounts. It charged late payment fees on around 2.4 million occasions, for which it received $75 million.

Mr Paciocco claimed the bank could not enforce the late payment fees because they were “penalties”. Australia’s common law will not allow a party to a contract to enforce a penalty amount under a contract. The question the High Court grappled with was what precisely did the common law understand a penalty to be. Rather annoyingly the Court has returned to the bad habit of each of the five judges hearing the case writing a separate decision. Each judge’s decision covers much of the same ground as the others, with subtle differences here and there. This makes it rather difficult to discern any coherent majority view on any particular issue.

In any event, the Court appeared to agree that a “fee” amounts to being a penalty if it is in the nature of a punishment for non-observance of the credit card contract. That is, it is a penalty if the fee is out of all proportion to the costs or loss caused to the bank by the customer’s late repayment. One view was that a fee becomes a penalty if it is extravagant, exorbitant or unconscionable. That definition sets a very high hurdle for bank customers to surmount when trying to prove a fee is a penalty.

Having decided what a penalty is, the judges were required to determine whether the fee/penalty charged was out of all proportion to the resulting losses caused to the bank. ANZ admitted the late payment fees were not a genuine pre-estimate of the losses it suffered as a result of the late repayment. The Court, however, found the mere fact there was no pre-estimate of the losses to the bank did not automatically mean it was a penalty.

Experts differ

Two expert witnesses gave evidence before the lower courts about the costs to the bank of a customer making a late repayment. One witness estimated the average cost to be $2.60. The other expert took into account a range of factors including the “loss provision costs, regulatory capital costs and collection costs” to the bank, and arrived at a much higher figure.

The Court then debated which of the experts had adopted the correct methodology. The majority found in favour of the second witness, the minority judge found the correct figure was closer to that calculated by the first witness, and therefore found the late repayment fee to be a penalty.

The majority also considered whether the bank had acted unconscionably or unjustly under the provisions of relevant legislation, and concluded that the bank had not breached the legislation.

The case confirms that a person alleging a requirement under a contract to make a certain payment amounts to a penalty must jump a very high bar. He or she must establish that the amount being imposed is extravagant, exorbitant or unconscionable.

The case also illustrates the difficulty in calculating the costs to the bank of customers making late repayments. The onus is on the customer to show the bank is acting extravagantly. It is somewhat disappointing for the many bank customers who are subjected to late payment fees that the Court favoured a costing methodology that itself was arguably extravagant and exorbitant.

Justin Malbon does not work for, consult, own shares in or receive funding from any company or organisation that would benefit from this article, and has disclosed no relevant affiliations beyond the academic appointment above.

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