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3 AUGUST 2016

Implications for the Commonwealth from the ANZ liquidated damages case

The beneficiary of a liquidated damages clause no longer needs to necessarily establish that the fee payable represents a genuine pre-estimate of the likely damages that would be recoverable for breach of contract; the question to be asked is whether the fee is 'out of all proportion' to the interests of the party in the contract being performed.

What was decided?

The High Court recently handed down its decision in *Paciocco v Australia and New Zealand Banking Group Limited* [2016] HCA 28 (*Paciocco*) – hopefully the final chapter in the long-running saga of whether the ANZ's credit card late-payment fees ($35 and later $20) were lawful.

The High Court upheld the Full Court of the Federal Court's decision that the ANZ's fees were lawful and not unenforceable penalties.

The High Court held that the 4 tests of what amounts to a penalty outlined by Lord Dunedin in the leading case of *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79, whilst useful, should not be understood as a limiting rule. The key question is 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'.

What 'interests' can be covered by liquidated damages?

In *Paciocco* the majority held that a party's legitimate interests in the performance of a contract may be of a business or financial nature, and such interests are not restricted to just a genuine pre-estimate of damages that could be recovered for breach of contract under the general law.

In deciding that the ANZ's late-payment fees were not penalties, the majority considered the evidence provided by the ANZ's expert witness at trial, Mr Inglis, about the type and nature of the ANZ's potential costs in situations where credit card holders did not pay their balance on time. These costs included:

- operational costs – the costs to ANZ of ensuring that the late payments were made, such as staffing and other administration costs
- increase in loss provisions – the reduction in the value of Mr Paciocco's loan, as recorded in the ANZ's accounts, was a category of loss
- regulatory capital costs – an additional amount of capital that ANZ is statutorily required to hold to cover unexpected losses.

Although not all such costs might be recoverable in contract, Justice Kiefel found that:

> The effect of Mr Inglis' evidence was to identify potential costs to the ANZ, from late payments, which reflect injuries to its financial position. They were real because they had to be taken into account by the ANZ. … It cannot therefore be concluded that the sums of $20.00 and $35.00 were out of all proportion to the interests so identified.

What should Commonwealth agencies do now?

Paciocco confirms the scope of issues that can be properly taken into account when engineering appropriate liquidated damages provisions. The case is a timely reminder for Commonwealth agencies to review and update their approach to liquidated damages and fee clauses – and ensure that, when these provisions are included in contracts, they reflect the particular context of the transaction to better protect the Commonwealth's interests.

Text of the decision is available at: http://eresources.hcourt.gov.au/showCase/2016/HCA/28.

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