Law Council
OF AUSTRALIA

30 August 2007

Committee Secretary
Senate Economics Committee
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

Email: economics.sen@aph.gov.au

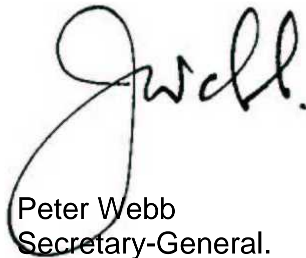
Dear Sir/Madam,

Inquiry into the Australian Securities *and* Investment Commission (Fair Bank & Credit Card Fees) Amendment Bill 2007

I am pleased to attach a submission prepared by the Australian Consumer Law Committee of the Law Council of Australia's Legal Practice Section, on the Inquiry into the Australian Securities and Investment Commission (Fair Bank & Credit Card Fees) Amendment Bill 2007.

Due to time constraints, this submission has not been considered by the Directors of the Law Council of Australia.

Yours sincerely,



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Submission to the Inquiry into the Australian Securities & Investment Commission (Fair Bank and Credit Card Fees) Amendment Bill

Senate Standing Committee on Economics

Submission by the Australian Consumer Law Committee
of the Law Council of Australia

30 August 2007

Submission to the Senate Economics Committee

Inquiry into the Australian Securities & Investments Commission (Fair Bank and Credit Card Fees) Amendment Bill

Introduction

1. The Australian Consumer Law Committee ("**the Consumer Law Committee**") of the Law Council of Australia supports the intent of the *Australian Securities & Investments Commission (Fair Bank and Credit Card Fees) Amendment Bill* 2007 ("**the Bill**") in seeking to regulate the imposition of fees and charges by suppliers of financial services on consumers. The issue of the level of fees charged by financial service providers is an important one that has the ability to significantly impact on consumers who often have little practical choice between financial service providers. Low-income earners in particular are likely to be adversely impacted by dishonour and over-limit fees. However, the Consumer Law Committee is of the view that the Bill in its current form is problematic and requires significant amendment in order to accurately reflect the current state of the common law and to adequately regulate the imposition of fees and charges by financial service providers.

"Penalty Fees"

2. The Consumer Law Committee's brief analysis of fees charged by the four major Australian banks (NAB, Commonwealth Bank of Australia, ANZ and Westpac) support the contention that some fees charged by them may be excessive. For example, NAB and Westpac impose a direct debit dishonour fee of $50 and Westpac and ANZ charge over-limit fees on credit card users of $35.[1] Other fees, for example 'stop cheque' fees, are significantly lower and may be reasonable, although it is difficult to analyse the reasonableness of the fees without substantial investigative work being done.

3. A contract cannot impose a fine or penalty. The power to impose fines and penalties requires legislative backing. Fees and charges in civil contracts can only be imposed if they are a valid estimate of the loss caused to one contracting party by the breach of contract occasioned by the other. A valid clause in a contract that fixes an amount or sum to be payable as damages upon breach of the contract by one party is called an "agreed damages clause". The monetary sum set by an agreed damages clause must be a genuine pre-estimate of loss or damage caused by the breach. The pre-estimate can be as high as the amount that could genuinely be the greatest

[1] Figures taken from CHOICE analysis of bank fees as at May 2007. See: http://www.choice.com.au/viewArticle.aspx?id=104817&catId=100210&tid=100008&p=4&title=The+low-down+on+penalty+fees [accessed 28 August 2007]

loss or damage arising from the contractual breach: *O'Dea v Allstate Leading System (WA) Pty Ltd* (1983) 152 CLR 359. However, as held by the House of Lords in *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* [1915] AC 79:

> *"if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach" then it is a "penalty" and the clause imposing that penalty is invalid and unenforceable* ab initio[2]*."*

4. If a contractual provision is held to impose a penalty rather than being a reasonable agreed damages clause, then the clause will be severed from the contract as unconscionable. The whole of the contract between the bank and the consumer will not be struck down. The clause will be held to be unenforceable *ab initio* and invalid. As stated in *Citicorp Australia Ltd v Hendry* (1985) 4 NSWLR 1,[3]

> *". . . if an amount required to be paid upon breach of contract was not a genuine pre-estimate of the damages flowing from breach of the particular term then the penalty clause was unenforceable* ab initio*. This follows, in my opinion, from the rule that whether stipulated sums are penalties or liquidated damages is a question to be judged at the time of the making of the contract: thus if stipulations are penalties they are so at the same moment as the contract is formed; agreement and unenforceability are simultaneous… In my opinion, at the present day, the fact that a penalty clause is unenforceable means that it has no legal effect; the party for whose benefit it would operate if it was enforceable can at no stage enforce it or obtain the help of the law in any way in deriving any benefit from it. It is the same as if it was not in the agreement at all."*

5. Money paid pursuant to a penalty clause in a contract may be recoverable by the consumer as a debt due to it, under a common law claim for moneys 'had and received' as enunciated in *Roxborough v Rothmans of Pall Mall Australia Ltd* [2001] 208 CLR 516. This may be offset by the financial service provider's claim for its reasonable loss arising from the breach of contract.

6. The net effect of the common law of contract is that where a contract imposes an extravagant amount as a penalty, a person who pays the penalty can claim compensation for the difference between the extravagant amount and the reasonable sum for loss arising from the breach of contract.

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[2] "from the beginning" Regarding a penalty being unenforceable ab initio, see eg the New South Wales Court of Appeal in *Citicorp Australia Ltd v Hendry* (1985) 4 NSWLR 1 at 23-24; 39.
[3] per Priestley JA at 39.

Factors to be considered in determining whether a charge is a penalty

7. Whether a stipulated sum is a penalty "is a question of construction to be decided upon the terms and inherent circumstances of each particular contract, judged of as at the time of the making of the contract, not as at the time of the breach": *Dunlop Pneumatic Tyre Co* and *Public Works Commissioner v Hills* [1906] AC 368. Construction of the contract is a question of substance rather than form, and does not depend on the description by the parties but rather the operation of the clause: *O'Dea v Allstate Leading.*

8. There are various factors or tests that may be relevant to determine whether a certain sum is a penalty. In the case of dishonour and over-limit fees, the magnitude of the payment compared to the loss or damage arising from the breach is the primary consideration.

9. However, in *AMEV-UDC Finance Ltd v Austin* (1986) 162 CLR 170 it was held that the mere fact that the clause stipulates for payment of a sum that exceeds what would be recoverable under common law principles governing the award of damages is not enough to indicate that the sum is a penalty. It is a question of degree, which depend on circumstances such as:

   > "(1) the degree of disproportion between the stipulated sum and the loss likely to be suffered by the plaintiff, a factor relevant to the oppressiveness of the term to the defendant," and
   >
   > "(2) the nature of the relationship between the contracting parties, a factor relevant to the unconscionability of the plaintiff's conduct in seeking to enforce the term".

10. Other cases that have endorsed the *Dunlop Pneumatic Tyre Co* test have generally compared the sum in question with the "greatest loss that could conceivably be proved to have followed from the breach" (*O'Dea v Allstate Leading*) or "damage likely to be suffered as a result of breach" (*AMEV-UDC v Austin*) or "loss likely to be suffered" (*Esanda Finance Corporation Ltd v Plessnig* (1989) 84 ALR 99). If the sum charged is clearly greater than the likely loss the clause will be struck down if it is "extravagant, exorbitant or unconscionable" (*Esanda*) or "out of all proportion"(*AMEV-UDC*). It also has been held that the agreed term should be struck down as a penalty only if it is either extravagant in amount or "imposes an unconscionable or unreasonable burden upon a party" (*AMEV Finance Ltd v Artes Studios Thoroughbreds Pty Ltd* (1989) 15 NSWLR 564).

11. It is the Consumer Law Committee's preliminary view that some dishonour fees and over-limit fees charged by the main four banks are "extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach" (*Dunlop Pneumatic*

Tyre Co). A further analysis of the reasonableness of the cost of fees is outlined in paragraphs 15 to 17 below.

Provisions of the Bill

12. The use of the term 'penalty fees' throughout the Bill is problematic. The Bill in its present form arguably gives rise to an assumption that providers of financial services in certain circumstances can legitimately impose 'penalty fees' on consumers. As stated above, however, at common law, penalty provisions in a contract are invalid and unenforceable *ab initio*.

12FA Penalty fees if customer cannot control liability

13. The terminology of this provision may give rise to the assumption that penalty fees are allowable in certain circumstances, namely if a consumer had actual or constructive knowledge that a transaction would fail. However, as outlined above, penalty provisions in contracts are always invalid at law. Whether the consumer had actual or constructive knowledge that the transaction would fail is irrelevant in determining whether a fee is a penalty and thus unenforceable. The attempt in 12FA to prohibit the imposition of 'penalty fees' in certain circumstances is misconceived, in that it presumes that penalty provisions in contracts between financial service providers and consumers are in some instances allowable.

14. However, the Consumer Law Committee supports the intent of the proposed section 12FA in seeking to prohibit the imposition by financial service providers of fees on consumers who have no control over a default against their account. In particular, although many financiers have now discontinued the practice, some continue to charge 'deposited cheque dishonour fees', whereby a fee is imposed on a consumer depositing a cheque written by a third party when that cheque is subsequently dishonoured.

Recommendation

- The Consumer Law Committee recommends clause 12FA be amended to reflect the intention of the draftsperson. The Consumer Law Committee is happy to provide the Senate Economics Committee with a redrafted form of this provision at its request.

12FB Penalty fees to be reasonable estimate of loss

15. The Consumer Law Committee supports the intent of this provision in seeking to prohibit the imposition of fees by financial service providers that are more than the reasonable estimate of loss to the provider caused by consumer defaults. This reflects in broad terms the position at common law that a contractual clause allowing for the imposition of a sum that is not a genuine pre-estimate of loss or damage arising from the breach is a penalty and thus

severable from the contract. The clause again uses the term “penalty fee” which again the Consumer Law Committee takes issue with as such fees are currently unenforceable.

16. The task of calculating the costs to financial service providers of a default by a consumer is near impossible for the consumer. This is because the financial service providers have the information that will enable the calculation of such costs and that information is not available to the public. With respect, it is submitted that the Bill should provide for ASIC to be provided with the costings that financiers rely on to justify such charges and that ASIC be empowered to review the costings and make and enforce demands for the reduction of fees and charges that are considered by ASIC to be not reasonable.

17. Analysis done elsewhere[4] has suggested, using 2004 data, that financial service providers could be charging consumers between 5 and 16 times the actual cost incurred to the provider when they are required to process a dishonoured cheque. Estimates for electronic direct debit dishonour fees suggested that financial service providers charged consumers between 64 and 92 times the actual cost to the provider of processing a dishonoured direct debit. While these figures are based necessarily on a number of assumptions, given that financial service providers do not make available the means for calculating the real costs to them of consumer default, the figures do suggest at the very least that there is a significant degree of overcompensation to some financial service providers for default by consumers.

Recommendations:

- The Consumer Law Committee recommends that clause 12FB be amended to correctly reflect the intention of the draftsperson to proscribe excessive fees and charges in financial service contracts. The Consumer Law Committee is happy to provide the Senate Economics Committee with a redrafted provision at its request.

- The Consumer Law Committee recommends that a clause be inserted into the Bill requiring suppliers of financial services to provide the costings relied on by them for their fees and charges to ASIC and for ASIC to have the power to review the costings and to make and enforce demands for the reduction of those fees and charges that are considered by ASIC to be not reasonable. The Consumer Law Committee is happy to provide the Senate Economics Committee with a redrafted provision at its request.

[4] Consumer Law Centre of Victoria (2004), *Unfair Fees: A report into penalty fees charged by Australian banks*, [2.5.2].

12FC Enforceable undertakings

The Consumer Law Committee supports the intent of this provision but again takes issue with the use of the term “penalty fee” as such fees are currently unenforceable and the clause may unwittingly give parliamentary authority to the imposition of penalty fees where ASIC has accepted an undertaking.

Recommendations:

- The Consumer Law Committee recommends that clause 12FC be amended to correctly reflect the intention of the draftsperson to give ASIC the power to oversee the fees and charges that financial service providers have in their contracts. The Consumer Law Committee is happy to provide the Senate Economics Committee with a redrafted provision at its request.