22 April 2008

Law Council
OF AUSTRALIA

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

By email: economics@aph.gov.au

Dear Mr Hallahan

Inquiry into the Australian Securities and Investment Commission (Fair Bank & Credit Card Fees) Amendment Bill 2008

The proposed *Australian Securities and Investment Commission (Fair Bank & Credit Card Fees) Amendment Bill 2008* has been considered by the Australian Consumer Law Committee of the Law Council's Legal Practice Section, and by the Financial Services Committee of the Business Law Section.

Whilst both Committees are agreed that legislative action should be taken to prevent penalty fees and charges, they differ on whether the proposed Bill is the best method of achieving this result.

The Australian Consumer Law Committee of the Legal Practice Section supports the proposed Bill.

The Financial Services Committee of the Business Law Section considers that the proposed national unfair contract terms legislation is a better method of dealing with problem of penalty fees and charges in all industries, rather than by the proposed Bill which is limited to the financial services industry.

Please find attached the detailed views of each Committee.

Yours sincerely,

Margery Nicoll

Margery Nicoll
Director, International

GPO Box 1989, Canberra,
ACT 2601, DX 5719 Canberra
19 Torrens St Braddon ACT 2612

Telephone **+61 2 6246 3788**
Facsimile +61 2 6248 0639

Law Council of Australia Limited
ABN 85 005 260 622
www.lawcouncil.asn.au

Law Council
OF AUSTRALIA

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

Submission by the Financial Services Committee of the Business Law Section of the Law Council of Australia

Senate Standing Committee on Economics

22 April 2008

Submission by the Financial Services Committee of the Business Law Section of the Law Council of Australia

Inquiry into Australian Securities and Investments Commission (Fair Bank and Credit Card Fees) Amendment Bill 2007

This submission is made by the Financial Services Committee of the Business Law Section of the Law Council of Australia. The Law Council of Australia represents the legal profession at the national level and promotes the administration of justice, access to justice and general improvement of the law. The Financial Services Committee is compromised of lawyers with specialised legal knowledge and experience in financial services law.

Executive Summary

In view of the proposed implementation of national unfair contract terms legislation, it is inappropriate to proceed with the proposed Bill.

Detailed submission

The proposed Bill seeks to prohibit unfair fees and charges by banks and other financial service providers.

The charging of unfair fees is not limited to banks and other financial institutions. Unfair fees and charges by telecommunications and utilities companies also feature large in consumer complaints ("Unfair contract terms in Victoria: Research into their extent, nature, cost and implications" Consumer Affairs Victoria Research Paper No. 12 October 2007).

We submit that, to deal with the issue of unfair fees and charges on an industry-by-industry basis is inefficient and that the issue of unfair fees and charges (and other unfair terms in contracts) should be dealt as part of the proposed implementation of national unfair contract terms legislation.

National unfair contract terms law is one of the recommendations in the Draft Report of the Productivity Commission Review of Consumer Policy Framework. The Council of Australian Government at its meeting on 26 March 2008 agreed that the enhanced national consumer policy framework drawing on the final report of the Productivity Commission would be developed for the October meeting of COAG.

We refer the Committee to Chapter 7.5 (Unfair contracts legislation) and Chapter 9 (Access to remedies) of the Draft Report of the Productivity Commission.

Law Council
OF AUSTRALIA

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

Submission by the Australia Consumer Law Committee of the Legal Practice Section of the Law Council of Australia

Senate Standing Committee on Economics

22 April 2008

Further Submission to the Senate Economics Committee

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

The Australian Consumer Law Committee ("the Consumer Law Committee") of the Law Council of Australia has previously made submissions to the Senate Economics Committee on the proposed Bill, dated 30 August 2007 and 6 September 2007.

As the *Australian Securities & Investments Commission (Fair Bank and Credit Card Fees) Amendment Bill* ("**the Bill**") has now been revised and tabled in Parliament, the Consumer Law Committee makes the following further submissions on the Bill.

Introduction

1. The Consumer Law Committee supports the intent of 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.

"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, as at 17 April 2008, NAB and Westpac impose a direct debit dishonour fee of $30 and $50 respectively (NAB's dishonour fee was, until 22 February 2008, also $50) and Westpac and ANZ charge account overdrawn fees of $40 and $35 respectively.[1] Other fees, for example 'stop cheque' fees, are significantly lower and may be reasonable, although it is difficult 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

[1] Figures taken from CHOICE analysis of bank fees as at May 2007, as well as review of the websites of banks on 17 April 2008 for up to date information. 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]

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 loss or damage arising from the contractual breach: *O'Dea v Allstates Leasing 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

---

[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.

extravagant amount and the reasonable sum for loss arising from the breach of contract.

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 Allstates Leasing.*

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 Allstates Leasing*) 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 14 to 16 below.

Provisions of the Bill

12. The Consumer Law Committee has previously made recommendations on redrafting the previous draft bill to include aspects of that bill with which the Committee had concerns. The bill as revised now responds to most of those concerns. However, the Committee notes its general comments below.

12FA Default charge to be genuine estimate of damage

13. 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.

12FB Valid default charge

14. The Consumer Law Committee supports the intent of section 12FB in granting ASIC the authority to require a financial service provider the information and methodology relied on by that provider to calculate any default charges in its contracts, and to, based on that information, determine the quantum of a valid default charge.

15. 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.

16. 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

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

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.

12FC Fees when consumer default results from a third party default

17. The Consumer Law Committee supports the intent of section 12FC 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.

12FD Enforceable undertakings

18. The Consumer Law Committee does not comment on this provision.

12FE Multiple default charges void

19. The Consumer Law Committee supports the intent of section 12FE to limit the number of default charges that a financial service provider may impose on a consumer and the circumstances in which default charges can be imposed.

12FF Multiple default charges void

20. The Consumer Law Committee does not comment on this provision.

Recommendations to the Senate Standing Committee

21. The Consumer Law Committee notes that the Reserve Bank of Australia has released information that suggests that, in the 2006 financial year 18 Australian banks earned $4 billion in revenue from fees imposed on Australian households and $9.8 billion from all fees including fees charged to business customers. This figure includes fees raised from housing and personal loans, as well as credit cards, deposit accounts and 'other fees'. For the 2006 financial year, from the total RBA figure of $4 billion fee income earned from households, $2.725 billion is recorded as fees earned by all Australian banks from credit cards, deposit accounts and 'other fees'.[5]

---

[5] Reserve Bank of Australia, 'Reserve Bank Bulletin May 2007 - Banking fees in Australia', available at http://www.rba.gov.au/PublicationsAndResearch/Bulletin/bu_may07/banking_fees_aus.html [accessed 1 August 2007].

22. However, information available from the Reserve Bank of Australia is not disaggregated to reveal the quantum of fees earned from consumer defaults. The Senate Standing Committee on Economics may consider it valuable to obtain this disaggregated information from Australian banks, building societies and other credit providers.

23. Further, while it may be the purpose of the proposed legislation to enable ASIC to access information regarding the cost to banks of processing consumer defaults, this information is not currently publicly available. It may substantially benefit the Senate Standing Committee on Economics in having this information made available to them by the banks for the purposes of their Inquiry into the Bill.

24. The Consumer Law Committee suggests adding the following clause to the Bill to ensure that the legislation may not be circumvented by otherwise void 'default charges' being reformulated and imposed as 'service charges'. It is suggested that the provision read in similar terms to the following:

12FG Multiple default charges void

(1) A financial service provider must not include in any contract between the financial service provider and a consumer, a fee for service or any other charge relating to the account of that consumer, which is more than a genuine pre-estimate of the likely cost to the financial service provider of providing that service to the consumer.