IN THE HIGH COURT OF AUSTRALIA

MELBOURNE REGISTRY No M220 of 2015

ON APPEAL FROM THE FULL COURT OF THE FEDERAL COURT OF AUSTRALIA

BETWEEN: **LUCIO ROBERT PACIOCCO and another**

Appellants

and

AUSTRALIA AND NEW ZEALAND BANKING GROUP LTD (ACN 005 357 522)

Respondent

RESPONDENT'S SUBMISSIONS

Part I: Publication

1. These submissions are in a form suitable for publication on the internet.

Part II: Issues

2. The Respondent (**ANZ**) agrees that the Appellants' appeal presents the issues identified by the Appellants.

3. The issue raised by the Respondent's Notice of Contention is whether an action for "*relief from the consequences of a mistake*" within the meaning of s 27 of the *Limitations Act* 1958 (Vic) includes an action by a person to recover money paid on the basis of mistaken belief that he or she was legally obligated to make the payment. The issue arises only in respect of late payment fee 4 and only if that fee is found to be penal.

Part III: Judiciary Act 1903 (Cth), s 78B

4. ANZ considers that no notice is required to be given pursuant to s 78B of the *Judiciary Act* 1903 (Cth).

Part IV: Facts

5. The following matters stated in the Appellants' summary of facts are contested.

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6. As to the terms and conditions stated in paragraph 7, interest was not charged on borrowings by reason of late payments. Interest was charged if the full closing balance of the account (ie the full amount of borrowings) was not paid by the due date shown on the statement (regardless of whether the minimum monthly payment was made or not)[1]. The applicable interest rate was not increased if there was a late payment (ie the minimum monthly payment was not paid by the applicable date).

7. As to the circumstances in which the credit card contracts were entered into stated in paragraph 8, the contracts were terminable at will and the customer was under no obligation to retain the accounts or undertake transactions on the accounts[2].

10 8. As to the circumstances in which the late payment fees were charged to Mr Paciocco stated in paragraphs 10 and 11, also relevant are the credit limit on Mr Paciocco's accounts and the debit balance as at the time of default (both of which affected the calculation of loss provisions required to be taken up by ANZ and regulatory capital required to be held by ANZ). The following table amends the Appellants' table to include the credit limit and outstanding debit balance[3]:

Card	Fee number	Fee amount	Minimum amount due	Days late	Credit limit	Outstanding (debit) balance on the account
9522	9	$35	$203	37	$15,000	$10,199.27
	10	$35	$426	6	$15,000	$11,220.91
	38	$20	$383.44	5	$18,000	$18,025.44
9629	14	$20	$43	27	$4,000	$2,145.60
	17	$20	$10	14	$4,000	$268.38
	36	$20	$135.72	24	$4,000	$4,055.72

9. The trial judge's findings concerning the costs incurred by ANZ from Mr Paciocco's late payments stated in paragraph 10(d) were premised on her Honour's conclusion that loss provisions and the cost of regulatory capital could
20 not be recognised because they were only accounting costs or part of the costs of

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[1] Trial Reasons, Annexure 2: September 2006 Conditions of Use, cl 20.
[2] Trial Reasons [122]; Full Court Reasons [346].
[3] The table is based on Trial Reasons [9] and Annexures 1 and 3.

running a bank[4]. In the context of the penalty issues, the Full Court rejected that reasoning as to those categories of costs[5].

Part V: Statutes and regulations

10. The Appellants' statement of applicable constitutional provisions, statutes and regulations is accepted.

Part VI: Argument

Observations about the material facts

11. The credit card accounts held by Mr Paciocco were revolving lines of credit, as well as cash advance and payment facilities[6]. The first step towards default in repayment of the full amount of the money advanced on a credit card account is the failure to meet a monthly repayment obligation. The failure to make a monthly repayment when due is an objective indicator of increased credit risk[7]. The increased credit risk associated with such accounts was not addressed by an increase in interest rate charged[8].

12. In this appeal, there is no dispute that late payments on credit card accounts caused ANZ to incur additional costs[9]. The dispute is whether those additional costs are relevant to the determination of whether the late payment fee is a penalty. The Full Court found that late payments on credit card accounts cause ANZ three categories of costs.

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[4] Trial Reasons [150] - [151], [155].

[5] Full Court Reasons [161] – [170]. The Full Court also found that increases in loss provisions and the costs of regulatory capital occasioned by late payments were relevant to the assessment of the statutory causes of action (the subject of Appeal M219 of 2015): Full Court Reasons [330]-[334].

[6] Exhibit 4, Statement of Agreed Facts (Consumer Card Accounts), [24]-[33].

[7] As observed by Colman J in *Lordsvale Finance v Bank of Zambia* [1996] QB 752 (***Lordsvale***) at 763, a borrower in default is not the same credit risk as a prospective borrower with whom the loan was first negotiated and money is more expensive for a greater credit risk. See also *David Securities Pty Ltd v Commonwealth Bank* (1990) 23 FCR 1 at 27-31 per Lockhart, Beaumont and Gummow JJ (not being the subject of appeal to the High Court).

[8] ANZ's contractual right to charge interest on the debit balance of a credit card account arose at the time of the borrowing and continued for the period of the borrowing. That right was not related to and was not affected by late payment behaviour of the account holder. Late payments did not alter the interest rate charged by ANZ, nor alter the debit balance. Instead, the late payment fee was charged if the required monthly repayments remained outstanding 28 days after the end of the statement period.

[9] There was no appeal from the trial judge's findings of primary fact concerning provision costs, regulatory capital costs and collection costs.

(a) First, when ANZ's customers fail to meet a monthly repayment obligation on a credit card account, ANZ is required by AASB 139 to take up a loss provision in its accounts as an estimate of the (present) impairment to the value of its financial assets (including the credit card loans)[10]. Late payments increase the assessed risk of default in repayment of borrowings on the account and cause an increase in ANZ's loss provisions[11]. The loss provision reflects a present reduction in value of the asset, not a future reduction[12]. The provision is carried to ANZ's profit and loss account[13].

(b) Second, as an authorised deposit-taking institution, ANZ is required by Australian Prudential Standards to hold regulatory capital to cover unexpected losses[14]. ANZ's capital adequacy is measured by the ratio of its capital base to its risk weighted assets (the capital ratio)[15]. As the risk of default of its assets (including credit card loans) increases, ANZ is required to hold additional regulatory capital[16]. For that reason, late payments cause an increase in the amount of regulatory capital required to be held by ANZ[17]. Regulatory capital has a cost to ANZ. It is the loss of the additional return, over and above the return ANZ is actually able to earn on that regulatory capital, that ANZ is required and able to earn so as to provide an adequate return to the providers of its capital[18].

(c) Third, late payment of credit card accounts may trigger collections activity by ANZ to recover the amounts due, which includes contacting overdue customers by phone in respect of the outstanding amounts[19]. The evidence was that the duration of phone calls could vary from 1 to 20 minutes and, at

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[10] Trial Reasons at [144]-[149].
[11] Trial Reasons [147]. See also Exhibit 27, Inglis Late Payment Event (**LPE**) Report [5.36]-[5.42].
[12] Trial Reasons [144]. See also Exhibit 27, Inglis LPE Report [5.2]-[5.10].
[13] Trial Reasons [145]. See also Exhibit 27, Inglis LPE Report [5.6].
[14] Trial Reasons [152]. See also Exhibit 27, Inglis LPE Report [6.3] and [6.5].
[15] Exhibit 27, Inglis LPE Report [6.16].
[16] Trial Reasons [153].
[17] Trial Reasons [153]. See also Exhibit 27, Inglis LPE Report [6.49]-[6.54].
[18] Trial Reasons [154]; Exhibit 27, Inglis LPE Report [6.59]. The increased cost of regulatory capital incurred by ANZ from late payments is not reversed even if future account behaviour results in a reversal of the underlying provision: Full Court Reasons [170].
[19] Trial Reasons [157].

the lower of the estimates of Mr Inglis, had a resource cost to ANZ of $2.09 per minute[20].

13. The late payment fee compensated ANZ for the additional costs caused by late payments. In the absence of an agreed fee, ANZ would have been required to calculate the costs arising upon each late payment event by each customer and seek recovery of the same[21]. Even if the costs were confined to collections activity, the costs of calculating and recovering the same on an individual transaction basis would be expected to exceed the late payment fee[22].

The issues at trial and on appeal

14. The trial judge correctly stated the legal principles governing the penalty doctrine[23]. The principles were not the subject of controversy on appeal and were endorsed by the Full Court[24]. There was no error in the statements of the relevant principles by the trial judge or the Full Court. They are consistent with prior decisions of this Court and UK authorities[25].

15. The key question addressed before the Full Court was whether the trial judge had assessed the "extravagance" of the late payment fee as at the time of breach (by reference to the costs actually incurred by ANZ by reason of Mr Paciocco's late payments), rather than as at the date of contract (by reference to the costs that might conceivably be incurred)[26]. The Full Court concluded that the trial judge had erred in that respect[27]. The Full Court upheld ANZ's appeal in respect of the late payment

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[20] Full Court Reasons [176].
[21] The alternative would have been for ANZ to absorb the costs, with the result that all credit card customers would pay for the costs caused by the defaulting behaviour of others.
[22] Upon a *quantum damnificatus* (to recover costs incurred following the finding of a penal stipulation), the costs of calculating and recovering costs are themselves recoverable: *Tall v Ryland* (1670) 1 Ch Cas 183; *Blake v East India Co* (1674) 2 Ch Cas 198; *Johnes v Johnes* (1814) 3 ER 969 at 975; *In Re Dixon* [1900] 2 Ch 561 at 578-579; *Shiloh Spinners Ltd. v. Harding* (1973) AC 691 at 722; Story (Equity Jurisprudence s. 1311): "if the plaintiff were ready to pay or compensate the damage really incurred with interest and costs, then he was prepared to do equity, and so he was entitled to seek equitable relief against payment of the larger sum".
[23] Trial Reasons [13]-[48].
[24] Full Court Reasons [19] – [27].
[25] Including the recent decision of the UK Supreme Court in *Cavendish Square Holding BV v Talal El Makdessi* [2015] UKSC 67 (4 November 2015) (***Cavendish***).
[26] Full Court Reasons [112].
[27] Full Court Reasons [52], [53], [117], [152] and [153].

fees because on the evidence the late payment fee was not shown to be penal[28]. Contrary to the Appellants' submissions[29], the Full Court did not find that the late payment fees were "prima facie" penalties.

16. In this appeal, the Appellants advance two principal arguments:

(a) that the imposition of the late payment fee resulted in Mr Paciocco being required to pay a larger sum than the amount initially due, thereby activating the "second rule" in *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd*[30] and rendering the first rule unnecessary or inapplicable;

(b) alternatively, that the assessment of "extravagance" under the first rule in *Dunlop* is limited to contractual compensable loss and the costs of provisions and regulatory capital are not compensable because they are too remote.

The penalty doctrine

17. Before turning to each of the Appellants' arguments, it is necessary to say something about the penalty doctrine and the principles stated in *Dunlop*. The Appellants fall into error in treating Lord Dunedin's summary of the principles as a legislative code, in which the penalty doctrine is defined by four rules or tests[31]. Lord Dunedin's speech is often cited because it is a convenient summary of principles that have emerged from the decided cases. However, it is not a code and the principles cannot be read in isolation from the cases in which they were developed[32].

18. The overarching enquiry is whether the relevant stipulation has a penal character, in contradistinction to a compensatory character (usually labelled liquidated damages)[33]. In the cases, various synonyms have been used to describe the character or nature of a penal stipulation, such as punishment[34], security[35] or the

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[28] Full Court Reasons [184]-[187].
[29] Appellants' submissions [16].
[30] [1915] AC 79 (***Dunlop***).
[31] Appellants' submissions [22] and [23].
[32] cf *Cavendish* at [22] and [31].
[33] *Clydebank Engineering and Shipbuilding Company v Don Jose Ramos Yzquierdo Y Castaned* [1905] AC 6 (***Clydebank***) at 10 per Earl of Halsbury LC; *Public Works Commissioner v Hills* [1906] AC 368 (***Public Works***) per Lord Dunedin at 375-6; *Dunlop* per Lord Dunedin at 86.
[34] For example, *Dunlop* per Lord Parmoor at 100.

Latin phrase *in terrorem*[36]. As stated by Mason and Wilson JJ in *AMEV-UDC Finance Ltd v Austin*[37], equity and the common law exercise a supervisory jurisdiction not to rewrite contracts, but to relieve against provisions which are so unconscionable or oppressive that their nature is penal rather than compensatory. This focus of the enquiry was approved by this Court in *Andrews v ANZ Banking Group Ltd*[38].

19. The trial judge and the Full Court were correct in stating that a stipulation will not constitute a penalty at law or in equity unless it is extravagant and unconscionable in amount in comparison with the conceivable loss flowing from the breach[39]. The reason that the law of penalties only applies to a stipulated sum that is extravagant and unconscionable in amount was explained by this Court in *Ringrow Pty Ltd v BP Australia Pty Ltd*[40]: *"The law of contract normally upholds the freedom of parties, with no relevant disability, to agree upon the terms of their future relationships. ... Exceptions from that freedom of contract require good reason to attract judicial intervention to set aside the bargains upon which parties of full capacity have agreed. That is why the law on penalties is, and is expressed to be, an exception from the general rule. It is why it is expressed in exceptional language. It explains why the propounded penalty must be judged "extravagant and unconscionable in amount". It is not enough that it should be lacking in proportion. It must be "out of all proportion"."*[41]

The second test in Dunlop

20. The Appellants now place primary reliance on the so-called second test in *Dunlop*, arguing that it is the applicable test in the case of non-payment of money[42]. The Appellants' formulation and purported application of the second test is erroneous.

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[35] For example, *Waterside Workers Federation of Australia v Stewart* (1919) 27 CLR 119 (***Waterside***) at 131 per Isaacs and Rich JJ, citing *Peachy v Somerset* 1 Stra, 447 at 453.
[36] For example, *Clydebank* per Earl of Halsbury LC at 10.
[37] (1986) 162 CLR 170 at 193.
[38] (2012) 247 CLR 205 (***Andrews***) at [10].
[39] Trial Reasons at [14] and [39]-[44]; Full Court Reasons at [22], [25] and [95]-[98].
[40] (2005) 224 CLR 656 at [31]-[32].
[41] This is also the position in the United Kingdom: *Cavendish* at [22], [31]-[32] per Lord Neuberger and Lord Sumption (with whom Lord Clarke and Lord Carnwath agreed); [152] per Lord Mance; [244]-[248], [255] per Lord Hodge; [293] per Lord Toulson.
[42] Appellants' submissions [13], [17], [30].

21. As observed by the Full Court, the second test has its origin in Equity's historical rejection of an obligation or bond to pay a greater sum on failure to pay a lesser sum[43]. Those cases date from the mid-sixteenth century[44], at a time when interest on monies due was regarded as usurious and bonds were used to secure a principal sum due. In those circumstances, the "sum which ought to have been paid" was fixed and certain.

22. As acknowledged by the Appellants[45], interest and general damages can now be awarded for non-payment of money[46]. As Rossiter observes[47], the second test in *Dunlop* must now be read in light of the general right to relief upon default in payment of monies due. This was the approach taken by the Full Court of the Federal Court (Lockhart, Beaumont and Gummow JJ) in *David Securities Pty Ltd v Commonwealth Bank*[48]. The Full Court there held that amounts that comprise compensation to a bank with respect to funds it would otherwise have had available are not penal simply because they exceed the borrowed sum.

23. The "second test" was explained in the following terms by Coleridge J in *Reynolds v Bridge*[49], in a passage referred to with approval by this Court in *Andrews*[50]:

> "*...the principle seems to be, that, if you find a covenant the breach of which will occasion a damage, not uncertain, but such as is capable of being ascertained, as where there is a particular sum to be paid which is much less than the sum named as payable upon the breach, there it is held that the last named sum is specified by way of penalty, because a Court of equity would limit the amount to be actually paid.*" (emphasis added)

24. Likewise, Lord Parmoor in *Dunlop* described the "second test" in the following terms[51]:

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[43] Full Court Reasons [133].
[44] G A Muir, 'Stipulations for the Payment of Agreed Sums' (1985) 10 *Sydney Law Review* 503, 515.
[45] Appellants' submissions [38].
[46] See *Hungerfords v Walker* (1989) 171 CLR 125, cf *Wallis v. Smith* (1882) 21 Ch.D. 243 at 260, per Jessel, M.R.
[47] Rossiter, *Penalties and Forfeiture*, 1992, p 40.
[48] (1990) 23 FCR 1 at 31.
[49] *Reynolds v Bridge* (1856) 6 El & Bl 528 at 541.
[50] *Andrews* at [57].

> "*The second instance in which the Courts have sanctioned interference is in the case of a covenant for a fixed sum, or for a sum definitely ascertainable, and where the larger sum is inserted by arrangement between the parties, payable as liquidated damages in default of payment.*" (emphasis added)

25. It is apparent from the foregoing that the so-called "second test" is merely an illustration of the "extravagance" principle in a particular factual setting: where the amount due is a fixed sum or a sum definitely ascertainable. It was for that reason that Lord Dunedin referred to the second test as "truly a corollary" of the extravagance test. Contrary to the Appellants' suggestion, there is no disharmony in the tests[52].

26. As discussed above, the costs that may be incurred by ANZ by reason of late payments on credit card accounts are neither fixed nor easily ascertainable[53]. Where, as here, the lender is a bank conducting a business of lending money, default in timely repayment causes costs that are additional to principal and interest. The late payment fee compensated ANZ for the costs occasioned by the increased credit risk on the outstanding borrowings (the resulting increase in loss provisions and increased costs of regulatory capital) and the costs of collections activity. It is commercially apt that a lender be entitled to increased payments, whether in the form of fees or increased interest, from a borrower who has come to represent an increased credit risk[54]. Otherwise, the lender would need to allocate the costs of the increased risk of default across all of its borrowers, with the result that borrowers who are better credit risks would bear (in relative terms) higher borrowing costs.

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[51] At 101.

[52] Appellants' submissions at [40].

[53] As at the date of contract, ANZ could not know in advance what, at the time of late payment, the account balance would be, and what the customer's history of defaults would be, or whether and in what period a customer would rectify the late payment: see Full Court Reasons [182] – [183].

[54] *Lordsvale* at 763 per Colman J. See also the cases cited by Colman J, including particularly *Ruskin v Griffiths* (1959) 269 F. 2d 827 (cited at 765) and *Citibank N.A. v Nyland (CF8) Ltd* (1989) 878 F. 2d 620 (cited at 766). The reasoning in *Lordsvale* was referred to with approval in *Cavendish* at [26] per Lord Neuberger and Lord Sumption, at [146]- [148] per Lord Mance and at [222] per Lord Hodge. See also *David Securities Pty Ltd v Commonwealth Bank* (1990) 23 FCR 1 at 27-31 per Lockhart, Beaumont and Gummow JJ (not being the subject of appeal to the High Court).

27. The charging of the late payment fee did not involve the substitution of a larger amount for the principal debt owing. The fee was commercially justifiable within the continuing credit relationship and, as such, did not have a "penal" character[55].

28. Further, in assessing whether a collateral stipulation is a penalty, a relevant consideration is the difficulty involved in calculating the quantum of the loss that might be suffered by reason of the breach (or failure of the primary stipulation)[56]. A stipulated payment is more likely to be regarded as a bargain between the parties pre-estimating loss or compensation, and not as a penalty, when the consequences of the breach (or failure of the primary stipulation) upon which the payment is due are difficult or impossible to estimate[57]. In such cases, there are obvious benefits to parties to a contract in fixing the financial consequences of a breach (or failure of stipulation) and avoiding disputes[58].

29. For that reason, the Full Court correctly concluded that it is wrong to characterise the late payment fee as a demand for a larger sum upon failure to pay a smaller sum[59].

The surrounding circumstances and the parties' subjective intentions

30. In discussing the "second test" in *Dunlop*, the Appellants make reference to the surrounding circumstances at the time of the agreement and assert that ANZ's purpose in "fixing" the late payment fee was to secure the timeous payment of the money[60]. The trial judge made no such finding and correctly rejected the Appellants' argument that the surrounding circumstances included the parties' subjective intentions or purpose[61].

31. The penalty question is one of characterisation of the relevant stipulation, which requires consideration of the terms of the contract as a whole and "*the inherent*

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[55] cf *Lordsvale* at 763-764 per Colman J and *Cavendish* at [28] and [32] per Lord Neuberger and Lord Sumption, at [152] per Lord Mance and at [225] and [246] – [248] per Lord Hodge..
[56] *Clydebank* at 11 per Earl of Halsbury LC; *Dunlop* at 87-88 (Lord Dunedin), 95-96 (Lord Atkinson), 104 (Lord Parmoor); *Waterside* at 128-129 and 132.
[57] *Dunlop* at 87 per Lord Dunedin.
[58] *Robophone Facilities Ltd v Blank* [1966] 1 WLR 1428 (***Robophone***) at 1447, per Diplock LJ; *Murray v Leisureplay plc* [2005] EWCA Civ 963 at [106(vi)] per Clarke LJ; *Cavendish* at [259] per Lord Hodge.
[59] Full Court Reasons [137] - [138].
[60] Appellants' submissions [40], [41].
[61] Trial Reasons [124] – [126].

circumstances of each particular contract, judged as at the time of the making of the contract, not as at the time of breach"[62]. The task of characterisation is an objective rather than subjective exercise. The trial judge concluded that the expression "genuine pre-estimate of damage" does not invite an inquiry into the parties' state of mind at the time of contract; it is a phrase used in contradistinction to the concept of penalty[63]. The Full Court agreed[64].

32. That conclusion is consistent with the authorities. Lord Dunedin in *Dunlop*[65] derived the expression "genuine covenanted pre-estimate of damage" from Lord Robertson's judgment in *Clydebank Engineering and Shipbuilding Company v Don Jose Ramos Yzquierdo Y Castaned*[66] where His Lordship stated: "*Now the Court can only refuse to enforce performance of this pecuniary obligation if it appears that the payments specified were – I am using the language of Lord Kyllachy – "merely stipulated in terrorem, and could not possibly have formed" "a genuine pre-estimate of the creditor's probable or possible interest in the due performance of the principal obligation*"[67]. Lord Kyllachy had delivered the judgment at first instance, using similar language[68].

33. The expression "genuine covenanted pre-estimate of damage" is a description of a legal characterisation, not a description of an evidentiary enquiry into the parties' conduct or their subjective intent, purpose or calculations[69]. The fact that ANZ had not determined the quantum of the late payment fee [at the time of contract] by reference to a sum that would have been recoverable as unliquidated damages[70] did

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[62] *Dunlop* per Lord Dunedin at 86; see also *Cavendish* at [28] per Lord Neuberger and Lord Sumption.
[63] Trial Reasons [41], [129].
[64] Full Court Reasons [25] and [99] – [102].
[65] See *Dunlop* at 86.
[66] [1905] AC 6. The Earl of Halsbury LC did not use that expression, simply distinguishing between "an agreed sum as damages" and a "penalty to be held over the other party in terrorem (at 10). Similarly, Lord Davey approved the principle that a sum payable to enforce another stipulation is taken to be an assessment of damage unless it is extravagant and unconscionable in amount (at 17).
[67] Ibid at 19.
[68] (1903) 10 SLT 622 at 624.
[69] The converse is also true. As observed by Deane J in *O'Dea v Allstates Leasing System (WA) Pty Ltd* (1983) 152 CLR 359 at 400, a payment stipulation is not immunised from being a penalty by reason that the parties have "*subjectively intended to make a pre-estimate of damages in the event of breach*".
[70] The admission is set out in the Full Court Reasons at [139].

not mean that the fee was not a genuine pre-estimate of damage or that it was a penalty[71].

The fee was not extravagant or unconscionable in amount

34. The relevant issue is whether the late payment fee is penal in character. On the Appellants' pleading and by the application of longstanding principle (stated correctly by the trial judge and the Full Court) the question is whether, considered as at the date of contract and not at the date of breach, the fee was extravagant and unconscionable in amount in comparison to the maximum loss that might be incurred by ANZ from late payment. There was no dispute at trial or on appeal that the Appellants bore the burden of proving that the late fee was penal[72].

35. The Appellants did not contest that collections costs associated with late payments were a recoverable cost to ANZ[73]. Mr Inglis calculated the cost to ANZ of collections activity from late payments in various scenarios[74]. Mr Inglis' evidence was that in many scenarios those costs exceeded the fee[75]. The Full Court approved the methodology adopted by Mr Inglis. As observed by the Full Court, adopting the lower of Mr Inglis' calculations of collections costs ($2.09 per minute), and recognising that telephone calls could last from 1 minute to over 20 minutes, the cost of collection (looking forward) might be seen to exceed the fee[76]. Mr Regan did not give evidence as to ANZ's estimated collections costs on a forward-looking basis as at the date of contract[77].

36. The test is whether the fee (a relatively small amount - $35, reduced to $20 after 2009) is extravagant or unconscionable in comparison to the maximum conceivable loss. On the evidence of Mr Inglis, in many instances the costs of collections activity (the costs of contacting customers by telephone) alone would approximate or exceed the fee. Further, the expense of calculating the costs of collections activity incurred in respect of an individual late payment would also be recoverable costs. Looking only at those elements of the collections category of costs, the

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[71] Full Court Reasons [140] – [141].
[72] Trial Reasons [45]; Full Court Reasons [148].
[73] Trial Reasons [159].
[74] Trial Reasons [156], [157].
[75] Trial Reasons [157].
[76] Full Court Reasons [176].
[77] Trial Reasons [135], [159], [161]-[164]; Full Court Reasons [153].

evidence did not support the conclusion that the fee was extravagant and unconscionable in amount.

37. Contrary to the Appellants' submission[78], there was no finding at trial or on appeal that the costs of provisions and regulatory capital were too remote to be recovered. The Appellants' reference to Trial Reasons [44] and *Robophone*[79] is of no assistance: the trial judge was there referring to a different principle and, as discussed below, *Robophone* is against the Appellants' argument.

38. In respect of loss provisions, the trial judge concluded that a loss provision was only a cost in an accounting sense and did not represent a loss or damage incurred as a result of a late payment[80]. The Full Court rejected those conclusions, holding that the increased risk of default arising from late payment, which required ANZ to take up a loss provision flowing to its balance sheet and profit and loss account, was a legitimate object of compensation[81]. As Mr Inglis stated in his testimony at trial, the cost to ANZ occurs when the provision is made. At that time, the provision cost is recorded in the profit and loss account. The provision is not recording a future loss. It is a present loss, being the reduction in value of a loan by reason of the customer's behaviour (here, exception event behaviour)[82]. This was accepted by Mr Regan in cross-examination[83].

39. In respect of regulatory capital, the trial judge concluded that ANZ's increase in the cost of regulatory capital resulting from late payments is part of the costs of running a bank in Australia and no increase in the cost can be directly or indirectly related to any of the late payments by Mr Paciocco[84]. The Full Court rejected that conclusion, holding that the increased cost of regulatory capital occasioned by late

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[78] Appellants' submission [47].
[79] [1966] 1 WLR 1428.
[80] Trial Reasons [150].
[81] Full Court Reasons [164].
[82] Trial transcript: T196.43-197.10.
[83] Trial transcript: T197.24-198.11. As also accepted by Mr Regan in cross examination, looking forward, ANZ could not know whether or not Mr Paciocco would default in repayment of his borrowings: Trial Transcript T199.38-47. As at September 2013 (shortly prior to trial), and as the result of Mr Paciocco's defaults, ANZ held a loss provision of $701 in respect of Mr Paciocco's credit card account 9522 and an amount of $536 in respect of account 9629: Inglis Reply Report, p34, Table 4-3.
[84] Trial Reasons [155].

payment was a loss worthy of compensation and an interest worthy of protection[85]. The increased cost of regulatory capital incurred by ANZ from late payments is not reversed even if future account behaviour results in a reversal of the underlying provision[86].

40. On the footing that remoteness principles are applicable to the penalty assessment, the inquiry is (a) whether the loss claimed is "within the usual course of things" and (b) what may reasonably be supposed to have been in the reasonable contemplation of the parties at that time (that is, the knowledge of a reasonable person in the position of that party)[87]. That inquiry is objective and the focus is on the loss and damage which *should have been* appreciated by the contract-breaker or *would have been* appreciated by a reasonable person[88]. It is sufficient that the claimed damage is of a *kind or type,* and not the "precise concatenation of circumstances"[89], nor the quantum[90], which would have been within the reasonable contemplation of the parties, had they thought about the matter[91].

41. All of ANZ's costs occasioned by late payment fall within the "first limb" of *Hadley v Baxendale*[92], arising according to the "*usual course of things*" (for a bank), and not being unusual[93]. A reasonable person may be taken to understand that an account that is in default of its repayment obligations is at an increased risk of default and that in consequence financial costs would be suffered by a bank which lends money in the ordinary course of business.

42. ANZ's costs would in any event fall within the second limb because the parties had agreed the amount of compensation due upon late payment. As observed by Diplock LJ in *Robophone* in the context of considering the penalty doctrine[94]:

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[85] Full Court Reasons [167].
[86] Full Court Reasons [170].
[87] *Hadley v Baxendale* (1854) 9 Ex 341 at 354; *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64 (***Amann***), at 91-92.
[88] *C.Czarnikow Ltd v Koufos* [1969] 1 AC 350, at 385; *Amann* at 92.
[89] *Hughes v Lord Advocate* [1963] AC 837 at 853; *Rosenberg v Percival* (2001) 205 CLR 434 at [64].
[90] *Alexander v Cambridge Credit Corporation Ltd* (1987) 9 NSWLR 310 at 365–366; *Cripps v G & M Dawson Pty Ltd* [2006] NSWCA 81 at [38]–[39].
[91] *South Coast Basalt Pty Ltd v R W Miller & Co Pty Ltd* [1981] 1 NSWLR 356 at 364.
[92] (1854) 9 Ex 341 at 354.
[93] See *Amann* at 91.
[94] At 1448.

> *"The basis of the defendant's liability for the enhanced loss under the "second rule" in Hadley v. Baxendale is his implied undertaking to the plaintiff to bear it. ... But such an undertaking need not be left to implication; it can be express. If the contract contained an express undertaking by the defendant to be responsible for all actual loss to the plaintiff occasioned by the defendant's breach, whatever that loss might turn out to be, it would not affect the defendant's liability for the loss actually sustained by the plaintiff that the defendant did not know of the special circumstances which were likely to cause any enhancement of the plaintiff's loss. And so if at the time of the contract the plaintiff informs the defendant that his loss in the event of a particular breach is likely to be £X by describing this sum as liquidated damages in the terms of his offer to contract, and the defendant expressly undertakes to pay £X to the plaintiff in the event of such breach ... such a clause is enforceable whether or not the defendant knows what are the special circumstances which make the loss likely to be £X rather than some lesser sum which it would likely to be in the ordinary course of things."*

43. The Appellants (faintly) challenge the use of the phrase "maximum loss", substituting "likely damage"[95]. The phrase "maximum loss", or an equivalent such as "conceivable loss" or "greatest loss" is strongly supported by authority[96].

44. Despite having the burden of proof, the Appellants did not adduce evidence directed to a forward-looking assessment of potential loss. The trial judge observed that the parties were like ships passing in the night[97]. Mr Inglis provided expert evidence addressing, amongst other things, the maximum amount of costs that ANZ could conceivably have incurred as a result of a late payment[98]. In contrast, Mr Regan was instructed to identify the amounts needed to restore ANZ to the position

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[95] Appellants' submissions [51].
[96] *Commissioner of Public Works v Hills* [1906] AC 368 per Lord Dunedin at 376; *Dunlop* per Lord Dunedin at 87; *O'Dea v Allstates Leasing System (WA) Pty Ltd* (1983) 152 CLR 359 per Gibbs CJ at 369 and per Deane J at 400; *AMEV-UDC Finance Ltd v Austin* (1986) 162 CLR 170 per Mason and Wilson JJ at 181; *Esanda Finance Corp Ltd v Plessnig* (1989) CLR 131 per Brennan J at 148.
[97] Trial Reasons [132] – [133].
[98] Trial Reasons [132] - [133].

it would have been in had Mr Paciocco's late payments not occurred[99]. Thus, Mr Inglis' evidence was forward looking as at the date of contract whilst Mr Regan's evidence was backwards looking as at the date of breach (and focussed on actual breaches)[100].

45. The Full Court acknowledged that Mr Regan's evidence was relevant in so far as it weakened or undermined Mr Inglis' evidence[101]. Indeed, the Full Court had regard to Mr Regan's evidence in considering the factual issues in dispute in respect of ANZ's costs[102]. In circumstances where Mr Regan's criticisms of Mr Inglis' analysis were held not to establish that the fees were extravagant[103], it was open to the Full Court to prefer, and accept, the evidence of Mr Inglis.

The relevant measure of loss

46. Accepting the Appellants' contention that the test of extravagance is assessed by reference to damages recoverable at law in consequence of a breach of contract, and not to forms of loss which are too remote for the law to compensate[104], for the reasons given, the late payment fee is not extravagant in amount in comparison to the costs incurred by ANZ by reason of late payment

47. As discussed in the recent UK Supreme Court decision in *Cavendish*[105], in each of *Clydebank*, *Public Works* and *Dunlop* the test is framed not by reference to whether the loss is compensable under common law contractual principles, but by reference to the interest protected by the bargain[106]. The breaches of contract that triggered the challenged payments in each of those cases caused loss that potentially raised questions of remoteness. The UK Supreme Court approved the approach of Lord

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[99] Trial Reasons [135].
[100] Full Court Reasons [149].
[101] Full Court Reasons [150] and [184].
[102] Full Court Reasons [158], [161] – [177].
[103] Full Court Reasons [184] – [187].
[104] Appellants' submissions [46].
[105] *Cavendish* at [20] – [32] per Lord Neuberger and Lord Sumption, at [131] - [153] per Lord Mance, at [242] - [249] and [254] – [255] per Lord Hodge and at [293] per Lord Toulson.
[106] *Clydebank* at 15-17, 19 and 20; *Public Works* at 375-376; *Dunlop* at 91-93.

Atkinson in *Dunlop* who took into account the wider interests of Dunlop in its trading system, beyond the mere recovery of direct loss for breach[107].

48. In *Andrews*, this Court also endorsed the language used in Lord Atkinson's judgment in *Dunlop*, stating: "*Thus the critical issue, determined in favour of the appellant, was whether the sum agreed was commensurate with the interest protected by the bargain*"[108].

49. Hence, on this footing, the relevant assessment is whether the late payment fee "*imposes a detriment on the contract-breaker that is out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation*"[109]. Further, the interest of the innocent party is "*not necessarily limited to the mere recovery of compensation for the breach*"[110]. ANZ had a legitimate interest in receiving timely credit card payments and incurred costs in consequence of late payments. Even if any of those costs were too remote to be recoverable as common law damages, the late payment fee was not extravagant in comparison to that interest. The fee served a compensatory function and did not have a penal character.

Orders if appeal allowed

50. If (contrary to the foregoing) the appeal is allowed, the appropriate order is to remit the matter to the Full Court for determination of appeal ground 14 in appeal VID 149 of 2014, which concerned the actual loss suffered by ANZ by reason of the late payments by Mr Paciocco[111].

Part VII: Argument on the notice of contention

51. ANZ contends that actions for "*relief from the consequences of a mistake*" in s 27(c) of the *Limitations of Actions Act* 1958 (Vic) (**Limitations Act**) do not include an action by a person to recover money paid on the basis of mistaken belief that he

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[107] *Cavendish* at [23]-[24] per Lord Neuberger and Lord Sumption. See also at [137] and [143] per Lord Mance.
[108] *Andrews* at [75].
[109] *Cavendish* at [32] per Lord Neuberger and Lord Sumption. See also at [152] per Lord Mance, [255] per Lord Hodge and [293] per Lord Toulson.
[110] *Cavendish* at [23] per Lord Neuberger and Lord Sumption. See also [28], [32] per Lord Neuberger and Lord Sumption and [131], [145] and [152] per Lord Mance.
[111] The Full Court declined to deal with that appeal ground: Full Court Reasons [191].

or she was legally obligated to make the payment[112]. There is no prior consideration of the question by this Court.

52. The trial judge decided that s 5(1)(a) of the Limitations Act, was applicable to the late payment fee incurred by the First Appellant on 4 September 2006 (Exception Fee 4)[113]. There was no appeal from that decision[114]. The trial judge also decided that s 27(c) of the Limitations Act applied to the First Appellant's claim for relief in respect of Exception Fee 4[115]. In so deciding, the trial judge followed the decision of the House of Lords in *Kleinwort Benson Ltd v Lincoln City Council*[116]. The Full Court agreed[117]. Relevantly, Besanko J approved the reasoning in *Kleinwort Benson* and concluded that an ambulatory construction better advanced the inferred object of s 27[118].

53. The reasoning of the House of Lords in *Kleinwort Benson*[119] on this issue (found centrally in the judgment of Lord Goff[120]) is, with respect, unsound. The object of the provision, as revealed by the applicable extrinsic material, was expressly not to postpone time in cases where the plaintiff was ignorant of his or her legal rights. An ambulatory construction is inconsistent with the legislative object and leads to undesirable consequences.

54. The legislative history of s 27 is described in the reasons of Besanko J[121]. ANZ makes the following additional observations concerning that history[122]. First, as observed by Prof Handford[123], limitation periods were not part of the common law (in contrast to equity); they were imported by statute to restrict the bringing of

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[112] Notice of Contention dated 5 October 2015.
[113] Trial Reasons [354] and [362].
[114] Full Court Reasons [376].
[115] Trial Reasons [365].
[116] [1999] 2 AC 349 (***Kleinwort Benson***).
[117] Besanko J at [396] (with whom Allsop CJ and Middleton J agreed at [192] and [398] respectively).
[118] Besanko J at [396].
[119] [1999] 2 AC 349.
[120] Ibid at 388-389.
[121] Full Court Reasons [383] – [384].
[122] The relevant history is described in a recent decision of the Victorian Court of Appeal: *Levy v Watt* (2014) 308 ALR 748, [2014] VSCA 60, at [40]ff.
[123] P Handford, *Limitation of Actions – the Laws of Australia* (3rd ed, 2013), [5.10.280].

common law actions. Second, the extrinsic materials[124] reveal that the statutory purpose of s 26(c) of the *Limitation Act 1939* (UK) (**1939 UK Act**) (on which s 27(c) of the Victorian Act was based) was to postpone the running of time in common law actions based on mistake, which at that time were confined to actions based on mistake of fact[125]. The statutory purpose is explained in paragraph 23 of the UK Report, which is reproduced in full in the reasons of Besanko J[126]. The Report stated expressly that it was not intended to postpone time in circumstances where the plaintiff was mistaken as to his or her legal rights: "*We desire to make it clear, however, that the mere fact that a plaintiff is ignorant of his rights is not to be a ground for the extension of time. Our recommendation only extends to cases when there is a right to relief from the consequences of mistake*"[127].

55. While the word "mistake" in s 27(c) is capable of bearing the meaning mistake of law, the surrounding text strongly suggests that the intended meaning is mistake of fact. First, each of sections 27(a) and (b) concerns factual matters[128]. Second, each of paragraph (a), (b) and (c) is subject to the same qualification: that the period of limitation shall not begin to run until the plaintiff has discovered the fraud or the mistake, as the case may be, or could with reasonable diligence have discovered it. The qualification applies most naturally to mistakes of fact and is strained if applied to mistakes of law[129].

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[124] The Law Revision Committee 'Fifth Interim Report (Statutes of Limitation)' 1936 (Cmd. 5334) (**UK Report**).

[125] Section 27 of the Victorian Act, like s 26 of the 1939 UK Act, applies to actions "for which a period of limitation is prescribed by this Act".

[126] Full Court Reasons [384].

[127] At the time of the UK Report and the enactment of the UK equivalent of s 27(c), the common law allowed recovery of monies paid under a mistake of fact, but not of law, with the limitation period commencing at the time of payment. The reference to *Baker v Courage* [1910] 1 KB 56 in paragraph 23 of the UK Report makes clear that the authors of the UK Report intended that the equitable rule concerning postponement of time would apply to common law actions for recovery of monies paid under a mistake of fact. At that time, it was well established that equity would not interfere in cases of money paid under a mistake of law made by the payer: see *Rogers v Ingham* (1876) 3 Ch D 351 at 357.

[128] In respect of (a), the action must be based upon the fraud of the defendant; in respect of (b), the action must be concealed by the fraud of the defendant.

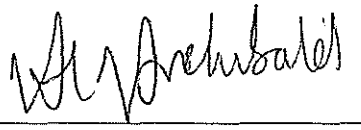
[129] For example, if so applied, would one assume that the plaintiff was in a position to obtain sound legal advice, including predictions about future legal developments? If so, the mistake should always be capable of being discovered. If that assumption is not made, what assumption about the availability of legal advice ought be made?

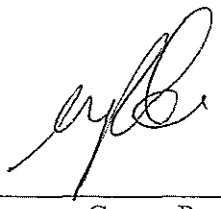
56. As Besanko J observed, this Court has not endorsed any presumption in favour of ambulatory construction[130]. There are strong reasons for not adopting an ambulatory construction. First, as noted above, the legislative history shows that, when Parliament enacted s 27, the purpose of the provision was to apply the equitable principle associated with postponement of time by reason of mistake to common law claims, including restitutionary claims for recovery of money paid under a mistake of fact, but not in the case of a plaintiff who was ignorant of his or her rights. Second, in this context, there is a significant difference between a mistake of fact and a mistake of law. As observed by Lord Lloyd of Berwick in *Kleinwort Benson*: "*... law, unlike facts, can change*"[131]. Which leads to the third point: an ambulatory construction gives rise to undesirable consequences, as adverted to by the House of Lords in *Kleinwort Benson*[132] and by Besanko J: "*...transactions considered final and settled might be upset many years after they have taken place on the basis of a mistake of law, possibly revealed by a subsequent judicial decision which reverses earlier authority*"[133]. Those undesirable consequences are a powerful reason not to adopt an ambulatory construction.

Part VIII: Estimate

57. ANZ estimates it will require a total of 4.5 hours for presentation of its oral argument in this appeal and in M219 of 2015.

Dated: 6 November 2015





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[130] Full Court Reasons [393] and [394], referring to *Forsyth v Deputy Commissioner of Taxation* (2007) 231 CLR 531 at [39]-[42].
[131] [1999] 2 AC 349 at 392.
[132] Per Lord Browne-Wilkinson at 364, Lord Goff at 389, Lord Hoffman at 401, Lord Hope at 417.
[133] Full Court Reasons [396].