IN THE HIGH COURT OF AUSTRALIA
MELBOURNE OFFICE OF THE REGISTRY

No M48 of 2012

BETWEEN

JOHN ANDREWS
First Applicant

ANGELO JULIAN SALIBA
Second Applicant

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GEOFFREY ALLAN FIELD
Third Applicant

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

APPLICANTS' REPLY

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13 July 2012
Filed on behalf of the applicants
Maurice Blackburn Lawyers
Level 10, 456 Lonsdale Street
MELBOURNE VIC 3000

DX: 466 Melbourne
Tel: (03) 9605 2765
Fax: (03) 9258 9610
Email: SFoale@mauriceblackburn.com.au
Ref: Steven Foale (3013752)

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Part I – Certification

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

Part II – Reply

The key differences between the parties

2. The following emerges from the Respondent's Submissions (**RS**): (*a*) ANZ does not dispute that there are decisions where relief has been granted on the basis of penalty at common law, and particularly in equity, *absent* any contract between the parties; (*b*) ANZ does not dispute that there are decisions, even where there *was* a contract between the parties, where the reasoning given for the grant of relief on the ground of penalty does not turn on the existence of a breach of contract; and (*c*) ANZ does not point to any decision where on a considered basis, in light of history and principle, a Court has explained *why* it is that the law has now narrowed to the point where the doctrine only applies if there was (*i*) a contract; and (*ii*) a breach of that contract (and perhaps, a breach sounding in damages).

3. What instead is offered by ANZ are a series of narrowing steps which are designed to get to the desired conclusion, but without having to grapple with the full demands of both history and principle. Those suggested steps are: (*a*) this Court should ignore bonds, other instruments and obligations which neither historically nor now conveniently fit a contractual analysis;[1] (*b*) the Court should ignore the fact that a penalty can be (and historically was) effected and secured by causes of action, other than for breach of contract, such as debt, assumpsit, account,[2] or even a common money count; (*c*) to the extent that there are contract cases where relief has been granted absent breach, some of them can safely be set aside as being in the special context of termination, where there may possibly be scope for the doctrine, although this need not be decided;[3] (*d*) what that primarily leaves within contract are those cases where the doctrine has had a lot of work to do in the last 100 years, namely, express secondary obligations to pay money on breach of primary obligations; (*e*) the decisions that do not neatly fit within (c) or (d) can be treated as 'equivalent' to contractual ones, or reinterpreted as cases of breach where the obligation is 'readily to be implied';[4] and (*f*) the doctrines in law and equity are now and have been for a long time the same, and there is nothing relevant to be gained from any differences between them.[5]

4. By this series of unsafe steps, ANZ reaches the results that: (*a*) 'penalty' has no meaning or purpose, other than as the doctrine limiting the extent to which parties can, through an exercise of freedom of contract, pre-estimate and thereby fix the damages which would otherwise be payable under the general secondary obligation which the law of contract recognises when a primary obligation is breached;[6] (*b*) the trial judge was therefore correct in her formulation of the doctrine of penalties, for both law and equity (which are the same), namely, that the law of penalties is confined to payment for breach of

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[1] See RS [43].
[2] See RS [42], and compare *Foley v Hill* (1848) 2 HL Cas 28 (9 ER 1002), and *Foley v Hill* (1844) 13 LJR (Montagu) 182.
[3] See RS [26] and [43], and compare the detailed historical analysis and reasons of Lord Denning in *Campbell Discount v Bridge* [1962] AC 600 at 629-631; and Deane J in *AMEV-UDC*.
[4] See RS [18], [43].
[5] See RS [19].
[6] See RS [44]. It is for this reason also that the notion that penalties not only requires a breach of contract, but also a breach sounding in damages, creeps into the argument: See RS [17]; RS [18]; RS [35].

contract.[7]

5. There are a number of errors in this, both in the treatment of the decided cases and in the reasoning process. *First*, by excising much of the territory where equity has applied the doctrine, the inquiry is inevitably blinkered. *Secondly*, the cause of action for 'breach of contract' never was a necessary element to be relieved from a penalty in equity. The usual circumstances were a legal action, and a plaintiff claiming at law to retain, extract, or threaten to extract a sum of money or property; taken across to Chancery, and coupled with a plea by the other party that, whatever the legal reason, the money or property was in truth being taken as a penalty. *Thirdly*, there has still not been any principled explanation as to *why* the doctrine in equity should be confined to cases of breach of contract. This is particularly so when the injustices, inconsistencies and arbitrariness of such a constraint are manifest, and not least amongst which is the ease of achieving the same improper objective by alternative means.[8] *Fourthly*, the answers really do lie in the principles applied by equity. Equity retains the jurisdiction to intervene to prevent the taking of unconscientious advantage of strict legal rights, which in this instance involves one citizen in using the ordinary private law recognition of consensual obligations to impose a punishment or extract, obtain or retain a penalty from another citizen. This is the essential insight of the statements of principle by Bramwell LJ[9] and Frankfurter J;[10] and another reason why the equitable doctrine should be formulated giving particular weight to the statements of principle by Story,[11] and Deane J in *AMEV-UDC*.

6. The better view is that, whatever the position at law, the equitable jurisdiction was not, and is not, confined to cases of *breach* of *contract*. It is capable of application in any case where one party has assumed a consensual obligation to pay money (or transfer property) to another, an obligation which the law would ordinarily enforce under any of a variety of causes of action, but which in all the circumstances of the dealings of the parties has strayed into the area of punishment or deterrence.

7. It follows that the trial judge's conclusion that the Exception Fees were not capable of constituting penalties because they were not payable on a breach of contract was in error, and the remainder of the cause should be returned for a first instance consideration of whether the Fees were being imposed on customers as penalties.

Substance over form?

8. The parties are in furious agreement that the equitable doctrine favours substance over form.[12] But they differ on what this means. For ANZ, as the doctrine can apply only to secondary contractual obligations liquidating the damages otherwise payable on breach, the 'substance' inquiry means simply: does the clause – however worded – operate in a

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[7] RS [14]. However, compare the formulations at RS [18] (equivalent circumstances); RS [19] (primarily applied); RS [43] (obligation while not express, was readily to be implied).

[8] Eg: The bringing of an action at law by the party imposing the penalty on a cause of action other than in contract, which does not allege breach; Within the contract, redrafting the terms so that the obligation to pay does not strictly arise for a breach as such; Within the contract, redefining the penalty so that it is expressed as a means of alternative performance, and thus does not occasion breach; Requiring that the party seeking relief to actually commit a breach, before any relief can be had.

[9] *The Protector Endowment Loan and Annuity Company v Grice* (1880) 5 QBD 592 at 596.

[10] *Priebe & Sons Inc v United States* 332 US 407 at 417 (1947).

[11] Story, *Commentaries on Equity Jurisprudence*, (1st Eng Ed., Grigsby, Stevens & Hayes, London, 1884), p905-6, (§1314).

[12] See RS [15], [39].

genuine way as an exercise of party autonomy to agree in advance the quantum of the damages which a judge or jury would otherwise address at large after the event in the light of all the facts as known; or has it strayed beyond this into punishment or deterrence? If 'yes' to the former, it is valid; if 'yes' to the latter, it is void and the damages will be assessed under ordinary principles.

9. But the *substance* approach has further work to do in other areas of the doctrine's application. Take the present case. The contract has stipulated in advance what is to be the agreed position on credit in respect of the account – either no credit or a pre-arranged limit or overdraft. The responsibility for keeping the account within that pre-arranged limit is placed on the customer as a matter of commercial reality which, for the most part, the language of the contract does not seek to hide ("You must not overdraw your account", *etc*). If the customer conducts the account – through careful management and sequencing of payments in and instructions to pay out - such that it remains within the pre-agreed limits, no fee (of the kind in issue here) ever becomes payable. On the other hand, if the customer operates the account such that, at the time the bank is called on to meet a given instruction, there are for any reason insufficient funds in the account to meet the instruction and remain within the pre-arranged limits, a fee becomes payable. The amount is substantial.

10. Equity will only interfere with the performance of these consensually assumed obligations if satisfied that the true nature of the obligations, viewed in the context of the relationship of the parties, has the character of punishment or deterrence. The inquiry therefore becomes: is the (objective) purpose for stipulating the obligations to pay the substantial sums whenever the customer has sought to operate the account beyond the pre-agreed limits one that can be properly related to some legitimate aspect of the banker-customer relationship?

11. ANZ does not posit that the sums have been extracted in advance with a purpose to compensate the bank for the losses it is likely to suffer if the relevant event occurs – here the event being the customer giving instructions which, if accepted, would see the account overdrawn. A substantial question for trial will then be whether ANZ can point to some other legitimate purpose within the banker-customer relationship, which justifies the extraction of the substantial fees and escapes the character of punishment or deterrence.

Must the 'breach' give rise to 'damage' or 'damages'?

12. ANZ wrongly contends that a condition of the grant of relief in equity was to make payment for the failure to perform the primary obligation; and this is elevated at RS [18] to one in which equity would not grant relief unless non-performance of the obligation gave an entitlement to 'damages'. The quote at RS [18] citing *Fry v Porter*,[13] even with the holder of the Seal calling on the Chief Judges of the common law courts, does not go nearly as far as ANZ suggests. *Fry v Porter* concerned the effect of a condition upon a gift in a will. Whatever else may have happened here, ANZ was not making conditional gifts to its customers. Next, the quote at RS [20] from *Kemble v Farren* (1829) 6 Bing

[13] (1670) 1 Mod 300 at 308. The case is also reported or digested at 1 Chan Cas 138 (22 ER 731); (1670) 1 Mod. 300; (1669-70) 2 Rep Ch 26 (21 ER 606). But Cf the reports at (1670) 1 Mod 300; 2 Com Dig 167; 1 Mod 300 (86 ER 898).

141 at 148; [1824-34] All ER 641 at 642 does not support the proposition. Tindall CJ was pointing to the *quantum damnificatus*. The better view is that *if* there was damage done by the party seeking relief, relief would only be granted on terms that that party could do equity. If the damage done was simple, it was usually (but not without criticism) limited to an order for principal, interest and costs; if there was something more, a common law trial was ordered to ascertain the *quantum damnificatus*. The *quantum damnificatus* cannot be equated with or subsumed under the secondary obligation in the modern law of contract to pay damages for breach. Nor is it the only conceptual means to deal with the point: the account is another. Accordingly, it does not
10 follow from the cases cited that equity could *only* intervene where there was damage to the plaintiff at law.[14]

Relevance of the US Cases

13. At RS [31] the Respondents assert that *Priebe & Sons v United States* 332 US 407 (1947) is an orthodox case of breach of contract, but its present significance is that the obligation to pay 'liquidated damages' was attached to a failure to have eggs inspected and ready for delivery on a date which *ante-dated* the time when delivery was actually due and which in no way interfered with contractual performance: at 410.6. The reason it was held to be a penalty was not that it provided for a sum which was extravagant and exorbitant in connection with the loss which might flow from a breach – ie a failure to
20 deliver on time – because there was no such breach. Instead, its purpose was to seize upon an event which could not cause damage and penalise its occurrence as an added spur to performance: at 413.1-6, 418. Further, the *Restatement of Law – Contracts Restatement (Second)*, at §356 (Liquidated Damages and Penalties) makes clear that penalties (*a*) are not confined to contracts (the Restatement separately addresses bonds); (*b*) are not confined to cases where the penalising party has suffered damages;[15] and (*c*) do not turn on any need for showing a breach. In respect of the latter, a common issue seems to have arisen from contracts structuring the penalty as an 'alternative means of performance.'[16]

14. At RS [30] ANZ cites *Tayloe v Sanford* 20 US 13 (1822) for the proposition that the US
30 Supreme Court has "also adopted the criterion of breach in defining the ambit of the Court's power..". Marshall CJ for the Court did not do any such thing. The Court was dealing with a case where the contract *expressly* stated that 'The said house is to be completely finished on or before the 24th of December next, *under a penalty* of 1000 dollars in case of failure." This was held to be a reservation of a sum in gross and not liquidated damages. The Court did not hold that all penalty cases are reduced to this type of situation, and indeed in the lengthy footnotes on p18-19 cited much of the stream of English equity jurisprudence on which the applicants rely.

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[14] Nor did the commentators see it that way: The full passage in Story shows he was dealing with contract (Cf the extract at J [35], with Story §1314); and both Story at §1326 (p661), and Pomeroy, *Equity Jurisprudence* (5th ed, The Lawyers Co-Operative Publishing Co, NY, 1941), Voll II, §458, treat with 'penalties' (and forfeiture) in respect of statutes, which would be pointless if the penalties were circumscribed by 'breach of contract' and 'damages'. Further, damage to the penalizing party cannot be the point: it would see relief to the party who *breached* and *caused loss*; but not for one who suffered but complied, or did not cause loss.

[15] See esp, the Commentary, 'Test of penalty' ("If, to take an extreme case, it is clear that no loss at all has occurred, a provision fixing a substantial sum as damages is unenforceable.")

[16] For a UK example, see *Chilliner v Chilliner* (1754) 2 Ves Sen 528 (28 ER 337).

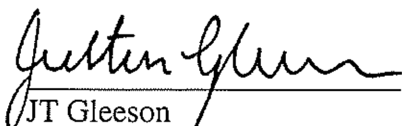
The appeal is not 'futile'

15. At RS [11] ANZ repeats a number of times that "Nor was there an 'obligation' of the kind described by Brereton J in *Integral* ... upon the customer not to overdraw the account": Fn 13, 15, citing J [82], [177], [185], [186], [191], [207]. Of these, paragraphs J [82], [177], and [207] concern the contractual analysis of 'request'; and J [185] and [186] reject any implied contractual term. That leaves J [191]. ANZ also repeats a number of times a conclusion that the fees did not arise on the occurrence of an event which the customer had an obligation to avoid: Fn 17, 22, citing J [193], [209], [215], [281], [293], [308], [324], [328], [331]. These references are the answers given by the judge to the separate questions; not any reasons why, or findings. The two propositions are marshalled in support of an argument that the applicants have not shown that their formulation of the equitable doctrine could assist on the facts.[17]

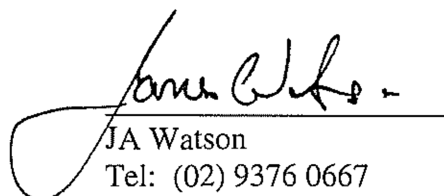
16. Sifting out the footnotes, the two propositions rest on J [191], which is where her Honour rejected the alternative submission by the applicants that "*the terms imposed a clear obligation of the kind described by Brereton J in Integral*", and therefore fall within the ambit of penalties. The trial judge rejected the submission primarily for the reasons set out at J [73] and [74]. The Reasons at J [73] and [74] contain her Honour's conclusions on the point of law, including a number of points about *Interstar* at first instance and on appeal.[18] Thus, the conclusion at J [191] was primarily premised on a rejection of the analysis of Brereton J, and not on findings in respect of the intention, purpose, or effect of the Exception Fees or contracts. To the extent her Honour made any further observation in J [191], it was to draw some points of factual distinction between the traditional money bond and the present agreements, which is hardly surprising. These points do not deny the capability of equity to grant relief.

17. Likewise, ANZ's criticism at RS [47]-[53] regarding Appeal ground 4 is misplaced. The ground goes to *capability* in law, and follows directly from success on grounds 1-3. *Actuality* of penalty will be decided at trial, once the erroneous requirement for breach of contract is removed and the Court has otherwise indicated the limits of equity. ANZ's propositions of 'no evidence' and 'inconsistency' can be dealt with in the full enquiry.

Dated: 13 July 2012



JT Gleeson
Tel: (02) 8239 0211
Fax: (02) 9210 0645
Email: justin.gleeson@banco.net.au



JA Watson
Tel: (02) 9376 0667
Email: watson@banco.net.au

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[17] See RS [14], [36].

[18] *Interstar Wholesale Finance Pty Ltd v Integral Home Loans Pty Ltd* (2008) 257 ALR 292; [2008] NSWCA 310.