

CASE UPDATE

ENGLISH COURT RULES THAT BANKS' UNARRANGED OVERDRAFT CHARGES ARE LARGELY INCAPABLE OF BEING PENALTIES

The Office of Fair Trading v Abbey National PLC and Others [2008] EWHC 875 (Comm)

The Office of Fair Trading v Abbey National PLC and Others [2008] EWHC 2325 (Comm)

Executive Summary

The English High Court has ruled that several banks' terms relating to charges for unarranged overdrafts on personal current accounts are largely incapable of amounting to penalties at common law. Such terms would therefore be valid and enforceable.

Background

In July 2007, the Office of Fair Trading (the "OFT") brought a test case against seven companies which operated major banks and a mutual building society, namely, Abbey National plc ("Abbey"), Barclays Bank plc ("Barclays"), Clydesdale Bank plc ("Clydesdale"), HBOS plc ("HBOS"), HSBC Bank plc ("HSBC"), Lloyds TSB Bank plc ("Lloyds TSB"), the Royal Bank of Scotland Group plc ("RBS") and Nationwide Building Society (collectively, the "Banks").

The OFT sought a declaration that certain unarranged overdraft charges (the "Relevant Charges") stated in the Banks' standard form contracts for personal current accounts (the "Relevant Overdraft Terms") were eligible for assessment for fairness under the unfairness rules of the Unfair Terms in Consumer Contracts Regulations 1999 (the "UK 1999 Regulations"). The Relevant Charges were imposed when the Banks were requested to make payments under circumstances where their customers did not have funds or facilities to cover the payments.

The Banks brought counterclaims seeking, among other things, a declaration that the Relevant Overdraft Terms were "not capable of amounting to" penalties at common law. (The court was not, however, asked to examine whether the Relevant Charges were extravagant or unconscionable and more than a genuine pre-estimate of loss.)

The High Court's Decision

The court held that the UK 1999 Regulations could be applied to assess the fairness of the Relevant Charges. As to penalties, the court ruled that most of the Relevant Overdraft Terms were not capable of amounting to penalties at common law.

MAIN OFFICE

20 Raffles Place
#17-00 Ocean Towers
Singapore 048620

t +65 6535 0733

f +65 6535 4906

mail@drewnapier.com
www.drewnapier.com

Co. Reg. No. 200102509E

This update will only examine the court's approach to the subject of penalties in the context of the Relevant Charges. There is no equivalent of the UK 1999 Regulations in Singapore.

Penalties: the law and approach

If a payment provision is penal, it will be unenforceable at common law. A penal payment provision is one that provides for payment upon a breach of a contract that is not a genuine pre-estimate of loss from the breach and where the stipulated amount is extravagant and unconscionable when compared to the prospective loss.

The court noted that a Relevant Overdraft Term is not capable of being penal unless the following three elements exist:

- the term must be of contractual effect, and not merely exhortatory or advisory;
- the term must impose an obligation or prohibition on the customer (rather than, for example, merely stipulating a condition precedent to an obligation on the Bank); and
- a charge must be payable upon a breach of that obligation or prohibition.

The test for determining the meaning and effect of a Relevant Overdraft Term is to ask what the words, in their context, would mean to a reasonable man. The "*substance of the arrangements between the bank and the customer*" must be considered. It would be relevant to consider whether the Relevant Overdraft Terms are set out in a leaflet or other document which expressly states that the terms are of contractual effect or which contains provisions which are (or some of which are) clearly contractual. Further, a Relevant Overdraft Term capable of giving rise to a penalty would usually be in "*normative or prescriptive language*" and would make the obligation or prohibition clear to the customer.

The court also recognised that, *prima facie*, a customer is not in breach of his contract with a bank if he gives instructions to make a payment without having the necessary funds or facilities to cover the payment (whether at the time when the instructions are given, received or both). The customer is, under such circumstances, usually taken to be requesting overdraft facilities. The bank is typically free to accede to or decline such a request.

Specific rulings

After analysing the Banks' Relevant Overdraft Terms, the court concluded that:

- (a) Barclays', Clydesdale's and HSBC's Relevant Overdraft Terms were not capable of amounting to penalties;
- (b) Abbey's and HBOS' Relevant Overdraft Terms were also generally not capable of amounting to penalties, save in respect of two sets of standard form terms and conditions which the court would examine at a later juncture with the benefit of further submissions and material; and
- (c) further submissions were required from Lloyds TSB and RBS in order for the court to decide the issue.

Comment

This case deals with the important question of whether charges which are routinely imposed by banks may be construed as being penalties, and therefore unenforceable. It also serves as a useful guide on the approach the courts take in interpreting standard bank documentation. Whilst the final result was largely favourable to the banks, it serves as a timely alert to banks of the creative challenges that may be mounted in respect of their existing practices and a reminder to review their standard documents regularly to ensure that they keep up with the developments in the law. Each case will, at the end of the day, have to be decided on its own facts and the bank's specific provisions.

If you would like more information about these cases, please feel free to contact any of the members of our **Financial Institutions Group**.

Drew & Napier LLC's **Financial Institutions Group** comprises a cross-practice team that includes market-leading dispute resolution specialists and a sterling banking and finance practice. Clients value our in-depth financial markets knowledge and regulatory expertise as well as the breadth and depth of our capabilities. We are their undisputed firm of choice for the most complex and ground-breaking international arbitration, litigation and regulatory enforcement matters and cross-border commercial and financial transactions. Our top-tier reputation for disputes and transactions, coupled with financial sector expertise, means that we are one of the very few leading practices that is uniquely equipped to provide the full suite of services to meet the business priorities and legal needs of our clients in the financial services industry. For further information, please contact:



Davinder Singh, SC

T +65 6531 2403
F +65 6532 7149
E davinder.singh@drewnapier.com



David Ang

T +65 6531 2236
F +65 6535 4864
E david.ang@drewnapier.com



Jimmy Yim, SC

T +65 6531 2504/2505
F +65 6533 9029
E jimmy.yim@drewnapier.com



Indranee Rajah, SC

T +65 6531 4100
F +65 6532 7149
E indranee.rajah@drewnapier.com



Harpreet Singh Nehal, SC

T +65 6531 2446
F +65 6532 7149
E harpreet.singh@drewnapier.com



Hri Kumar, SC

T +65 6531 2522
F +65 6532 7149
E hri.kumar@drewnapier.com



Cavinder Bull, SC

T +65 6531 2416
F +65 6533 3591
E cavinder.bull@drewnapier.com



Valerie Kwok

T +65 6531 2222
F +65 6535 4864
E valerie.kwok@drewnapier.com

Copyright in this publication is owned by Drew & Napier LLC. This publication may not be reproduced or transmitted in any form or by any means, in whole or in part, without prior written approval. Drew & Napier LLC accepts no liability for, and does not guarantee the accuracy of information or opinion contained in this publication. This publication covers a wide range of topics and is not intended to be a comprehensive study of the subjects covered nor is it intended to provide legal advice. It should not be treated as a substitute for specific advice on specific situations.