



The Bank of England

(Photo by kind permission)

Getting back the Charges

Steven Whiting, head of the probate and financial services department of Foy & Co., Solicitors, examines the legal position of banks in respect of their charges.

Under the terms and conditions of a customer's current account with a bank, there is invariably a clause which stipulates that, in the event of the customer putting the account into unauthorised overdraft, then the bank may make such charges to the account as it shall from time to time think fit, in accordance with its published tariff and, in addition to the payment of interest and other published monthly or quarterly overdraft charges. There is also invariably an express agreement by the customer that he will not put the account into unauthorised overdraft.

In contract, the enforceability of, say, a £20 charge to cover the cost of a letter, may depend upon whether the charge is deemed under the agreement between the customer and the bank to be a penalty or liquidated damages and, if it is a penalty, then whether the sum charged is a reasonable estimate of the bank's anticipated loss.

The situation

First, there is no doubt that the customer is in breach of his contract with the bank when he breaks his express agreement not to exceed the authorised credit limit and, as such, the bank is entitled to recover damages arising from the customer's breach.

However, the level of the charge levied by the bank is not as straightforward. It may be a genuine pre-estimate of the loss likely to be incurred by the bank, in which case, it will be liquidated damages

and it constitutes the amount, no more and no less, that the bank is entitled to recover. Alternatively, it may be a penalty intended to deter the customer from breaking the contract, which bears little relation to the damages likely to be sustained by the bank as a consequence of the breach; a threat "in terrorem".

The fundamental difference between the two is that penalties are subject to the equitable jurisdiction of the courts and that, since a penalty is "designed as mere security for the performance of the contract, the promisee is sufficiently compensated by being indemnified for his actual loss, and acts unconscionably if he demands a sum which, though certainly fixed by agreement, may well be disproportionate to the injury". (Cheshire & Fifoot: *Law of Contract*).

Cases

In *Law -v- Redditch Local Board (1892)* it was stated that "The distinction between penalties and liquidated damages depends on the intention of the parties to be gathered from the whole of the contract. If the intention is to secure performance of the contract by the imposition of a fine or penalty, then the sum specified is a penalty; but if, on the other hand, the intention is to assess the damages for breach of the contract, it is liquidated damages." (Cheshire & Fifoot: *Law of Contract*).

Further, one of the principal tests set out in the leading case of *Dunlop Pneumatic Tyre Company Ltd -v- New Garage &*

Motor Company Limited (1915) stipulates that the "conventional sum is a penalty if it is extravagant and unconscionable in amount in comparison with the greatest loss which could follow from the breach". (Cheshire & Fifoot: *Law of Contract*).

Conclusion

If we consider the damages which occur in this example, as a consequence of the customer's breach of the agreement, we see that remedies for the bank already exist, in that the customer is liable to pay a higher rate of interest on his unauthorised borrowing in addition to a monthly administration charge which arises.

It is also clear that the charge levied by the bank purely relates to the cost of the letter to the customer and not to the breach itself. In consequence, one must ask whether the charge is "extravagant and unconscionable in amount" in comparison with the anticipated or actual cost of sending the letter and whether the threat of the letter and of the associated charge is being used by the bank to "secure performance of the contract by the imposition of a fine or penalty".

As the amount of the charge levied is clearly in excess of the possible cost of a letter, providing a profitable source of income for the bank, it is a penalty and the bank will only be allowed to recover from the customer the amount of the actual loss sustained, that is the actual cost of the letter and not the charge levied ■