Before the High Court

Paciocco v Australia and New Zealand Banking Group Ltd: Are Late Payment Fees on Credit Cards Enforceable?

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Abstract

Paciocco v Australia and New Zealand Banking Group Ltd provides an opportunity for the High Court of Australia to clarify the application of the test in Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd to discern whether a credit card account fee is, in fact, a penalty. It also allows the High Court to consider whether bank fees are unconscionable, unjust or unfair within the meaning of various statutory provisions, in circumstances where the unconscionability is more substantive than procedural. If the bank customers are successful in arguing that the fees are penalties or unfair and unconscionable, it will allow other customers in class actions pending against banks to assert similar claims.

I Introduction

Over 10 years ago, in Ringrow Pty Ltd v BP Australia Pty Ltd, the High Court of Australia held that the test for deciding whether a contractual clause is, in fact, a penalty was stated by Lord Dunedin in Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd, and that a deeper consideration of the test should be left ‘to a future case where reconsideration or reformulation is in issue’. The day for further consideration has finally arrived with Paciocco v Australia and New Zealand Banking Group Ltd.

The High Court will consider whether late payment fees imposed by ANZ Bank on credit card accounts constitute penalties within the meaning of the Dunlop test. If the challenge by the banking customers is successful, it will allow other customers in class actions pending against banks to assert that payments made

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1 (2005) 224 CLR 656 (‘Ringrow’).
2 [1915] AC 79, 85–8 (Lord Dunedin) (‘Dunlop’).
3 (2005) 224 CLR 656, 663 [12].
4 High Court of Australia, Case Nos M219/2015 and M220/2015 (‘Paciocco’). Gordon J, the trial judge, is now a member of the High Court and will be unable to sit on the appeal.
under similar contractual provisions are void,\(^6\) or if the penalty is subject to the equitable doctrine, only enforceable to the extent of the actual loss suffered.\(^7\)

The High Court will also consider whether the fees were unconscionable, unjust or unfair within the meaning of certain statutory provisions.\(^8\) Statute may provide a better means to ascertain whether the late payment fees were unfair, although the fact that any arguable unconscionability is more substantive than procedural may prove a barrier.

II The Facts and the Challenge

The case involves a long-running class action. Customers of the ANZ Bank sued the bank in relation to five kinds of fees it had charged concerning transactions made on their accounts.\(^9\) The plaintiffs argued that the fees were not genuine pre-estimates of damage and were illegitimate penalties. They also argued that the fees were unfair, unjust and unconscionable within the meaning of various statutory provisions.\(^10\)

This is the second time the case has gone to the High Court. The present appeal concerns only one of the five categories of fee, the late payment fees payable on credit card accounts. The other categories of fee have been held not to be penalties or unfair or unconscionable pursuant to statute,\(^11\) and any appeal in relation to them has been dropped.\(^12\)

At first instance,\(^13\) the trial judge (Gordon J) held that honour fees, dishonour fees, non-payment fees and overlimit fees were incapable of being penalties because these payments were not triggered by a breach of contract. Her Honour was bound to hold this because the New South Wales Court of Appeal decision of \textit{Interstar}\(^14\) held that a breach of contract was necessary to attract the penalties doctrine.\(^14\) The late payment fees were capable of being penalties because they were triggered by a breach, namely the failure to pay on time.

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\(^7\) Andrews v Australia and New Zealand Banking Group Ltd (2011) 211 FCR 53 (‘Andrews Trial’);

\(^8\) Unconscionable conduct pursuant to ss 12CB and 12CC of the Australian Securities and Investments Commission Act 2001 (Cth) (‘ASIC Act’), unjust pursuant to sch 1 of the National Consumer Credit Protection Act 2009 (Cth) (‘National Credit Code’), and an unfair contract term pursuant to s 32W of the Fair Trading Act 1999 (Vic) (‘Fair Trading Act’) (which has since been repealed).

\(^9\) Honour fees, dishonour fees, non-payment fees, overlimit fees (payable where account balances exceed the credit limits for the statement periods) and late payment fees.

\(^10\) See above n 8.

\(^11\) Andrews v Australia and New Zealand Banking Group Ltd (2011) 211 FCR 53 (‘Andrews Trial’);

\(^12\) Paciocco v Australia and New Zealand Banking Group Ltd [2015] HCATrans 229 (11 September 2015) 18–19.

\(^13\) Andrews Trial (2011) 211 FCR 53.

\(^14\) Interstar Wholesale Finance Pty Ltd v Integral Home Loans Pty Ltd (2008) 257 ALR 292 (‘Interstar’).
The plaintiff appealed to the Full Federal Court, but, unusually, the High Court uplifted the appeal. The unanimous High Court held that the equitable doctrine against penalties had not ‘withered on the vine’, but still existed. The equitable penalties doctrine applied to a contract in which there was an ‘additional detriment’ imposed by a ‘collateral stipulation’ for the enforcement of a ‘primary stipulation’. Conversely, the equitable penalties doctrine did not apply to a contract containing an ‘alternative stipulation’ that provided ‘further accommodation’ for the provision of an extra right.

The case was remitted back to the trial judge for decision with a different representative plaintiff. Gordon J again held that only the late payment fees were capable of being characterised as penalties, regardless of whether the common law or equitable doctrine against penalties applied. However, the bank was not unfair, unjust or unconscionable within the meaning of any of the statutory provisions pleaded in relation to any of the fees.

Both parties appealed to the Full Federal Court. The Full Federal Court upheld Gordon J’s judgment apart from her finding as to the status of the late payment fees as penalties under the unwritten law. The Court differed from Gordon J in its application of the Dunlop test, and concluded that the late payment fees were not penalties.

The appeal to the High Court by the bank customers seeks to argue:

1. That the late payment fees are, in fact, penalties pursuant to Lord Dunedin’s test stated in Dunlop. It was argued in the special leave application that the Full Federal Court misapplied the Dunlop test.

2. If the late payment fees are not penalties, they are unconscionable, unfair or unjust within the meaning of the relevant statutory schemes. It was argued in the special leave application that the test regarding unconscionability pursuant to s 12CB of the ASIC Act had been misapplied in light of the qualifications to that test added to s 12CC of the ASIC Act.
III  The Dunlop Test

All parties in Paciocco agree that Lord Dunedin’s test in Dunlop ascertains whether a fee is, in fact, a penalty both at common law and in equity.\(^\text{21}\)

Dunlop holds that the essence of a penalty is a payment of money stipulated as \textit{in terrorem} of the offending party (that is, intended to frighten or intimidate), whereas the essence of a liquidated damages clause is a clause that constitutes a genuine agreed pre-estimate of damage.\(^\text{22}\) The question of whether a sum is a penalty or liquidated damages is a question of construction to be decided on the terms and circumstances of the contract, ‘judged of as at the time of the making of the contract and not as at the time of the breach’.\(^\text{23}\) Lord Dunedin went on to suggest a number of tests that ‘may prove helpful, or even conclusive’:

(a) It will be held to be a penalty 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.

(b) It will be held to be a penalty if the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid. This though one of the most ancient instances is truly a corollary to the last test. …

(c) There is a presumption (but no more) that it is penalty when ‘a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events, some of which may occasion serious and others but trifling damage’.

On the other hand:

(d) It is no obstacle to the sum stipulated being a genuine pre-estimate of damage, that the consequences of the breach are such as to make precise pre-estimation almost an impossibility. On the contrary, that is just the situation when it is probable that pre-estimated damage was the true bargain between the parties.\(^\text{24}\)

As noted earlier, this test was approved by the High Court in Ringrow, which qualified category (a) by saying that if a sum is extravagant and unconscionable, it must be ‘out of all proportion’ to the potential loss.\(^\text{25}\)

Justice Gordon and the Full Federal Court applied the Dunlop test to the late payment fees in different ways, and came to different conclusions. The High Court will be required to determine the correct application of the Dunlop test.

\(^{21}\) Arguably the status of Dunlop was left unclear after Andrews: Harder, above n 18, 145–6.

\(^{22}\) [1915] AC 79, 86.

\(^{23}\) Ibid 87.

\(^{24}\) Ibid 87–8 (citations omitted).

\(^{25}\) (2005) 224 CLR 656, 669 [32].
IV The Disagreement as to the Application of the Dunlop Test

At trial, Gordon J found that the late payment fee fell within category (c) of Lord Dunedin’s test because it was a single lump sum payable on the occurrence of a range of events.26 Her Honour also said that the fee might fall within category (b) of Lord Dunedin’s test, but to ascertain this, it was necessary to consider the interrelated question of whether the fee was a genuine pre-estimate of loss pursuant to category (a).27 In light of the expert evidence, her Honour decided that the loss to the bank was no more than $3,28 and in some instances, it was as little as $0.50.29 Given that the late payment fees were $35, it followed that the fee was vastly greater than the loss. Accordingly, the fees were extravagant and unconscionable within the meaning of category (a) of Lord Dunedin’s test.30

The Full Federal Court overruled Gordon J’s conclusions on the basis that her Honour had failed to take an ex ante analysis as at the date of the contracts to assess the greatest possible loss that could conceivably be proved to have followed from the breach.31 Chief Justice Allsop, with whom the other judges agreed, said it was necessary to decide whether a fee was extravagant and exorbitant before deciding whether the fee, in fact, exceeded the loss.32 The analysis should be forward-looking, and should assess whether the party imposing the fee had a legitimate interest in the performance. (Interestingly, in the recent decision in Cavendish, Lord Neuberger and Lord Sumption also emphasised the importance of a contracting party having a legitimate interest in performance.33) The fact that a clause fell within category (b) was not decisive, and did not alter the onus of proof.34 Other circumstances at the time of entry into the contract were relevant. The actual damage suffered by the bank was irrelevant, and the trial judge erred to the extent that her Honour considered the actual damage.

In any case, Allsop CJ said that the late payment fee did not fall within category (b) because it was a collateral stipulation, and extravagance or exorbitance should be assessed by the legitimate interest of the party imposing the fee, ‘assessed by the greatest loss that could conceivably be proved to have followed from a breach or failure to comply’.35 Unlike the trial judge, the Full Federal Court accepted the bank’s evidence as to its losses, which included provisioning for debt, the cost of regulatory capital and collection costs.

26 Paciocco Trial (2014) 309 ALR 249, 280 [119].
27 Ibid 280 [121].
28 Ibid 290 [173].
29 Ibid 292 [186], 302 [241].
30 Ibid 290 [173], 292 [187], 302 [241].
31 Paciocco FCAFC (2015) 321 ALR 584, 614 [112], 615 [117].
32 Ibid 614 [113]–[114].
33 Cavendish [2015] UKSC 67 (4 November 2015), [32] (Lord Neuberger and Lord Sumption, with whom Lords Clarke and Carnwath agreed): ‘The true test is whether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation’.
34 Paciocco FCAFC (2015) 321 ALR 584, 614 [115], citing Robophone Facilities Ltd v Blank [1966] 1 WLR 1428, 1447 (‘Robophone’).
35 Paciocco FCAFC (2015) 321 ALR 584, 619 [137].
Finally, while Gordon J was entitled to find that the fee prima facie fell within category (c) of the Dunlop test, insofar as her Honour then considered the actual damage flowing from the breach to see if the presumption applied, she was incorrect. 36

In the special leave application, Mr Jackson QC, for the bank customers, argued that the Full Federal Court was wrong to hold that the fee did not fall within (b), and that the simple and workable rule had been unduly amended by the Full Court. 37

V Judging Extravagance and Unconscionability

As Kiefel J observed in the special leave application hearing, principle is often ‘best understood by reference to its application to the facts’. 38 The High Court will be required to resolve a number of issues surrounding the application of Lord Dunedin’s test. At the heart of the appeal lies the methodology of judging extravagance and unconscionability.

The pivotal question is whether the assessment has to be entirely ex ante (the position of the Full Federal Court) or whether, as Nettle J asked in the special leave application hearing, an inference could be drawn from what happened subsequently as to what should have been foreseen at the outset. 39 This problem arises not only in penalties law, but in assessment of contract damages more generally. Case law in England and Australia has given different answers on whether events that occur after the breach of contract are relevant to the calculation of damages. 40

In Dunlop itself, the question of whether a clause was a penalty was to be assessed at the time of making the contract. 41 However, in Philips Hong Kong Ltd v Attorney General of Hong Kong, Lord Woolf said:

The fact that the issue has to be determined objectively, judged at the date the contract was made, does not mean what actually happens subsequently is irrelevant. On the contrary it can provide valuable evidence as to what could reasonably be expected to be the loss at the time the contract was made. 42

As the High Court has noted in another context, courts regularly consider subsequent matters when calculating compensation or value. 43 Lord Macnaghten famously said of an arbitrator’s duty to assess compensation: ‘Why should he

36 Ibid 618 [132].
listen to conjecture on a matter which has become an accomplished fact? Why should he guess when he can calculate? With the light before him, why should he shut his eyes and grope in the dark?’.44

Therefore, while the assessment of whether a fee is a penalty must be from the date of the contract, subsequent events may shed light on what was foreseeable at the outset.

This raises the further question of whether the ‘genuine pre-estimate of the loss’ must reflect the actual loss that the party who imposed the fee would recoup if she or he sued in contract for damages. The customers argued that the losses the bank said it sustained by reason of the customers’ failure to pay their credit card accounts on time were not losses that were recoverable as damages in contract. The losses in question, as noted earlier, were provisioning for debt, the cost of regulatory capital and collection costs.

In Robophone, Diplock LJ noted that it may appear that category (a) of Lord Dunedin’s test requires the pre-estimate of loss to comply with the first limb in Hadley v Baxendale45 (that is, losses that occur in the usual course of things). However, his Lordship said that the second rule in Hadley v Baxendale made a party liable for special losses liable to flow from the breach.46 Thus, a party to a contract could be made liable for special losses pursuant to an ‘implied undertaking’ to bear those losses. It was also necessary for the party to know that the enhanced loss was likely to result from the breach.47 However, if a contracting party stipulated that the loss in the event of breach would be a certain amount, and the other party expressly undertook to pay such sum, it was not a penalty unless the sum was not a genuine and reasonable estimate of the losses. His Lordship continued:

Such a clause is in my view 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 be likely to be in the ordinary course of things’.48

The question will be whether the High Court agrees with Diplock LJ in Robophone.

A matter not raised by the High Court in Andrews,49 nor during the High Court special leave application, was the disproportion in bargaining power between banking customers and banks. In AMEV-UDC, Mason and Wilson JJ said that ‘the nature of the relationship between the contracting parties’ was ‘a factor relevant to the unconscionability of the plaintiff’s conduct in seeking to enforce the term’.50

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44 Bwllfa and Merthyr Dare Steam Collieries (1891) Ltd v Pontypridd Waterworks Co [1903] AC 426, 431.
45 (1854) 9 Exch 341; 156 ER 145.
46 [1966] 1 WLR 1428, 1447–8. Moreover, a genuine pre-estimate of loss is not a penalty even if damages were unrecoverable under general law because of Shevill v Builders Licensing Board (1982) 149 CLR 620: see, eg, Esanda Finance Corporation Ltd v Plessnig (1989) 166 CLR 131 (‘Esanda Finance’).
47 Robophone [1966] 1 WLR 1428, 1448.
48 Ibid.
49 Katy Barnett and Sirko Harder, Remedies in Australian Private Law (Cambridge University Press, 2014) 306.
50 (1986) 162 CLR 170, 193.
While this dictum suggests that the nature of the relationship between the parties is relevant, it was later suggested by Wilson and Toohey JJ in *Esanda Finance* that the superior bargaining power of the financier should not be over- emphasised.\(^{51}\)

Nonetheless, Heydon, Leeming and Turner suggest that the surrounding facts of the transaction are pivotal.\(^{52}\) Therefore, the High Court may consider whether the fact that the customers entered standard form contracts with financiers with superior bargaining power was relevant for ascertaining whether the fee was unconscionable. This cuts to the heart of penalties law. As courts across the Commonwealth have observed, the penalties doctrine conflicts with the notion of freedom of contract, and accordingly the jurisdiction to relieve against penalties is used sparingly.\(^{53}\) However, a strong justification for the court’s intervention is the assertion that the person upon whom the penalty was imposed in fact had no freedom to negotiate or to seek alternative contractual terms, and therefore freedom to contract was not present. This has led some to suggest that the true problem is not penalties per se, but the misuse of market power in standard form contracting with consumers, and thus the penalties issue would be better dealt with by other common law and equitable doctrines, or by legislative provisions such as the unfair contract terms provisions in the *Australian Consumer Law*.\(^{54}\) Indeed, this observation leads us neatly to the bank customers’ second ground of appeal, which focuses on the statutory provisions.

**VI Statutory Provisions**

The bank customers alleged that the imposition of fees constituted unconscionable conduct pursuant to ss 12CB and 12CC of the *ASIC Act* and, prior to the operation of those sections, s 8 of the *Fair Trading Act*, or that they were unjust transactions pursuant to s 76 of the *National Credit Code*, or an unfair contract term pursuant to s 32W of the *Fair Trading Act*.

The equitable doctrine of unconscionable dealing covers situations where there is impropriety in the making of a contract: in other words, it deals with procedural unfairness. By contrast, legislative provisions such as s 12CB explicitly have a wider ambit (see s 12CB(4)(a)). The list of factors a court may take into account according to s 12CC include procedural concerns such as undue influence, but also extend to concerns that touch upon substantive unfairness in the contract,\(^{55}\) including: inequality of bargaining power;\(^{56}\) whether the consumer could obtain services from other suppliers under similar terms;\(^{57}\) and considerations of good

\(^{51}\) (1989) 166 CLR 131, 141–2.


\(^{54}\) *Competition and Consumer Act 2010* (Cth) sch 2; Harder, above n 18, 157–8.


\(^{56}\) *ASIC Act* s 12CC(1)(a).

\(^{57}\) Ibid s 12CC(1)(e).
faith.\textsuperscript{58} Similarly, s 76(2) of the \textit{National Credit Code}\textsuperscript{59} lists a series of matters, including inequality of bargaining power\textsuperscript{60} and the power of the customer to negotiate.\textsuperscript{61} Section 32X of the \textit{Fair Trading Act} also allows the court to take into account whether the term was ‘individually negotiated’.

It was indicated in the special leave application that a particular focus of the appeal will be on the special statutory nature of unconscionability pursuant to s 12CB of the \textit{ASIC Act}, and especially on the statutory stipulation in s 12CB(4) (as amended on 12 January 2012), which states that the consideration of unconscionability should not be limited to the circumstances relating to formation of the contract. It was said in the special leave application that the Full Federal Court had undertaken an analysis which was more in line with that required by s 12CA, which prohibits unconscionable conduct within the meaning of the unwritten law of the states and territories.

\section*{VII The Difficulty Facing the Bank Customers}

It will always be easier to persuade a court that a term is unconscionable, unfair or unjust if there are elements of procedural unfairness. However, that is difficult to show in this case, because the contracts were clearly worded and the customers understood the terms. The bank did not exert unfair pressure upon individual customers.

Consequently, the trial judge (Gordon J) found that: there was no unconscionable conduct within the meaning of the \textit{ASIC Act} or the \textit{Fair Trading Act} because there was no dishonesty, oppression, pressure or abuse of a commercially powerful position by the bank; that the fees were disclosed and the customers had capacity to understand that; and there was a capacity to ‘switch off’ the fees or terminate the banking contracts at will.\textsuperscript{62} The fact that the contracts were standard form contracts was not determinative.\textsuperscript{63} Gordon J found that the fees were not unfair or unjust, for the same reasons that her Honour had found that the fees were not unconscionable.\textsuperscript{64}

The Full Federal Court upheld Gordon J’s assessment, and gave short shrift to arguments that banks were engaged in cartel-style price fixing or monopolistic price setting.\textsuperscript{65} Indeed, the Full Federal Court said that the fee was ‘nominal’.\textsuperscript{66} This is a matter of perspective, and depends upon a person’s income. For some people, a fee of $35 will not be nominal.

\textsuperscript{58} Ibid s 12CC(1)(l).
\textsuperscript{59} \textit{National Consumer Credit Protection Act 2009} (Cth) sch 1.
\textsuperscript{60} \textit{National Credit Code} s 76(2)(b).
\textsuperscript{61} Ibid, s 76(2)(d).
\textsuperscript{62} \textit{Paciocco Trial} (2014) 309 ALR 249, 311 [290].
\textsuperscript{63} Ibid 312 [294].
\textsuperscript{64} Ibid 317–18 [323]–[325], 322 [352]–[353].
\textsuperscript{65} \textit{Paciocco FCAFC} (2015) 321 ALR 584, 658 [330].
\textsuperscript{66} Ibid 658 [331].
Statutory unconscionability is defined as something that is not done in good conscience and that is irreconcilable with what is right or reasonable.\textsuperscript{67} If there was any unconscionable conduct or unfairness in the imposition of bank fees, it was not in the sense of \textit{Blomley v Ryan},\textsuperscript{68} where a person was under a special disadvantage that rendered him vulnerable. It was on the basis that the fees are substantively unfair and unconscionable (the quantum does not reflect the loss). It is more like \textit{Earl of Aylesford v Morris},\textsuperscript{69} where the court remade a loan with a 60% interest rate into a loan with a 5% interest rate. The unconscionability was not based on a lack of understanding, pressure or unfairness, but on the substantive unfairness of the bargain itself. Similarly, any arguable unconscionability here lies in the substantive unfairness of the fees and in the lack of information available to customers, as discussed below.

Freedom of contract is dependent upon consumers having sufficient information to allow them to make informed choices about which accounts are best for them. While the trial judge was correct to observe that other banks charged different fees, and that the customers could potentially move to other banks, this ignores the fact that the customers would be faced with costs associated with switching accounts, and that information about the fees associated with accounts at other banks has not always been readily available.\textsuperscript{70} In May 2009, the Reserve Bank of Australia publicly released information about banking fees for the first time.\textsuperscript{71} Subsequently, on 29 July 2009, the National Australia Bank announced that it was dropping overdrawn account fees on all accounts.\textsuperscript{72} Other major banks then either lowered fees or dropped fees.\textsuperscript{73} The commencement of the \textit{Australian Consumer Law} on 1 January 2011, with its proscription of unfair terms, also meant that banks were wary about imposing fees. It is evident from Annexure 4 to the trial judge’s judgment that the ANZ Bank was no exception.

As suggested above, the legislature seems to have intended to prevent not only procedural unconscionability, but also some instances of substantive unconscionability. Any substantive unconscionability in this case was made possible by the lack of information provided to bank customers about fees, and the lack of fee-free banking options. However, substantive unconscionability remains a difficult basis upon which to mount a challenge. A very small percentage of contracts have been held to be unjust solely on the basis of substantive unfairness.

\textsuperscript{67} Australian Competition and Consumer Commission v CG Berbatis Holdings Pty Ltd (2003) 214 CLR 51, 72 [42]; \textit{Australian Competition and Consumer Commission v Lux Distributors Pty Ltd} (2013) ATPR ¶42-447, 43 467 [41].

\textsuperscript{68} (1956) 99 CLR 362, 405 (Fullagar J).

\textsuperscript{69} (1872–73) LR 8 Ch App 484.

\textsuperscript{70} Nicole Rich, ‘Unfair Fees: A Report into Penalty Fees Charged by Australian Banks’ (Report, Consumer Law Centre Victoria, December 2004) 10–11.


under the *Contracts Review Act 1980* (NSW). Courts remain reluctant to intervene in these circumstances. Consequently, parties must fall back on doctrines such as the penalties doctrine.

**VIII Conclusion**

The High Court needs to give guidance as to how Lord Dunedin’s test in *Dunlop* applies to contract clauses in light of the recent High Court decision in *Andrews*. The author suggests that the test is not solely an *ex ante* test, but that *ex post* occurrences may provide some guidelines as to what should have been foreseen. Moreover, hopefully the High Court will shed some light on the relevance of inequality of bargaining power to the doctrine.

The High Court should also clarify whether substantive unconscionability alone can justify statutory intervention. Considerations of freedom of contract do not have so much operation where there is not genuine freedom to contract, in the sense that customers cannot negotiate and did not previously have sufficient information to make fully informed contracting decisions.

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