IN THE COURT OF APPEAL OF NEW ZEALAND

CA655/2015
[2017] NZCA 152

BETWEEN	WILACI PTY LIMITED Appellant
AND	TORCHLIGHT FUND NO 1 LP (IN RECEIVERSHIP) First Respondent
AND	NZ CREDIT FUND (GP) 1 LIMITED Second Respondent

Hearing:	4 October 2016
Court:	Kós P, French and Miller JJ
Counsel:	N S Gedye QC and D F Jackson QC for Appellant R B Stewart QC, S M Hunter and M H A Ho for Respondents
Judgment:	2 May 2017 at 3.00pm

JUDGMENT OF THE COURT

A **The appeal is allowed.**

B **The High Court judgment is varied by deleting Order 2(a) and substituting therefor the following:**

> **"(a) Judgment against the plaintiff and the counterclaim defendant, jointly and severally, for AUD 31,477,194 being the late payment fees owing as at 31 July 2015 under clause 3.8 and paragraph (iv)(c) of Schedule 1 of the loan agreement plus interest thereon from 1 August 2015 and accruing daily and compounded monthly in accordance with clause 3.5 to the actual date of payment."**

C The respondents are to pay costs on a standard appeal on a band A basis together with usual disbursements.

D Costs in the High Court are to be dealt with in that Court, in accordance with this judgment.

REASONS OF THE COURT

(Given by Kós P)

[1] Is a late payment fee of AUD 500,000 per week, payable in the event of delay in repayment of a 60 day loan of AUD 37 million, an unenforceable penalty?[1]

[2] Fees and interest payable on the 60 day loan had been some $5.32 million. By the time the loan was repaid, by instalments across 19 months, the late payment fee exceeded a further $28 million.

[3] Muir J in the High Court held the late payment fee to be an unenforceable penalty.[2] The lender, Wilaci Pty Ltd, appeals.

[4] The essential issues on appeal are two:

(a) Is the common law doctrine against penalties engaged at all?

(b) Was the late payment fee an unenforceable penalty?

[5] A singular feature of the appeal is that we are to apply New South Wales law. That is the parties' choice of law governing the loan.[3]

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1 Hereafter in this judgment, references to currency refer to AUD unless otherwise stipulated.
2 *Torchlight Fund No 1 LP (In Receivership) v Johnstone* [2015] NZHC 2559 [*High Court Judgment*].
3 As to which, see [41] below.

Facts

[6] The background facts to the transaction are set out in great detail in the High Court judgment.[4] It is true that the old parol evidence rules discouraging the admission of evidence of negotiations have waned. But a sense of proportion is needed to ensure that the analytical exercise does not become overburdened with needless pre-contractual detail. Such detail is freighted with a relevance, and significance, it simply does not bear. It comes at a significant transactional cost to litigants in terms of documentary disclosure, evidence preparation and trial time. It impairs economic and expeditious access to justice. Proper limits are needed.

[7] Whether the late payment fee is an unenforceable penalty is primarily a question of construction of the loan agreement.[5] In cases where the issue is construction of a contract, evidence of wider background and circumstance may be considered, but not where it does no more than prove what the individual parties intended or understood their words to mean or what a party's negotiation stance might have been at a particular time. To the extent necessary, and no more than that, evidence of pre-contractual negotiations is admissible to establish facts relevant as background known to both parties or to establish their knowledge of circumstances relevant to their choice and use of words in the contract.

[8] In this case the meaning of the late payment fee clause is patent. The ultimate question is simply whether the effect of the late payment fee is exorbitant or unconscionable when regard is had to Wilaci's legitimate commercial interests in due performance of the loan contract. Admissible matrix evidence must therefore concentrate on facts that shed light on the nature of the parties' legitimate commercial interests and relevant transactional risks — including risk of loss of capital, collateral and reputation. This exercise focuses on the lender, but takes into account also the interests of the borrower.

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4 *High Court Judgment*, above n 2, At [5]–[65].

5 *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* [1915] AC 79 (HL) at 86 and 87; and *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67, [2016] AC 1172 at [9].

Admissible, relevant and necessary background matrix

[9] Torchlight Fund No 1 LP is a private equity fund. It invests in distressed assets. The second respondent is its general partner. It is jointly and severally liable for the unpaid liabilities of Torchlight. For all practical purposes, both entities were directed by Mr George Kerr.

[10] In August 2012 Torchlight was in what Mr Kerr called a "very tight liquidity situation". It was purchasing debt owed by a distressed Australian property company, RCL Group, to the Bank of Scotland International. The purchase price was $185 million. Torchlight had paid the Bank all but $37 million. That sum was now due on 17 August 2012, following an extension granted by the bank. Absent payment by that date, the Bank was likely to take enforcement action against Torchlight. Torchlight did not have the cash. A capital raising was planned, but there was insufficient time. Short term bridging finance was needed. As Muir J noted, but Mr Kerr did not acknowledge, capital raising had been made more difficult by a dispute that Mr Kerr had had with the Financial Markets Authority in New Zealand.[6] No capital raising ever took place.

[11] With less than two weeks to settlement with the Bank, and without the money, Torchlight (through Mr Kerr) contacted a financial intermediary. He was a Mr Andrew Skidmore. He was based in Singapore. Mr Kerr was aware that Mr Skidmore had previously sourced a substantial loan for a client from a very wealthy Australian businessman, a Mr John Grill. He was founder of the listed engineering services company WorleyParsons Ltd. Wilaci is a company controlled by Mr Grill.

[12] Two contextual points are important. First, Mr Grill (and Wilaci) were not normally in the business of making commercial loans. Torchlight knew that. Mr Grill was not looking for a rate of return reflecting the usual stance of a commercial lender such as a bank. Rather he was looking to gain a return commensurate with some form of short term investment.

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6 *High Court Judgment*, above n 2, at [9].

[13] Secondly, it was unlikely that a bank or other commercial lender would have provided Torchlight with finance of the kind sought. An expert witness called by Wilaci — Mr Morris Symonds, an investment banker based in Sydney— observed:

> A short term loan of this type will normally involve either a borrower which is desperate or which is expecting to make very high returns or achieve significant value uplift in a short space of time.

Mr Symonds' assessment was that that the transaction involved "an exceptionally high level of risk". No commercial lender in his experience would have funded it.

[14] The Judge accepted the evidence of Mr Skidmore that Mr Kerr's version of events was the money was needed on a short term basis to redomicile Torchlight from New Zealand to Australia, banks would not provide the funding necessary for that, and the requirement was for a short term facility only. The Judge rejected Mr Kerr's evidence that he had told Mr Skidmore at the outset the money was required to pay the Bank of Scotland.[7]

[15] Redomiciling the fund was the basis on which Mr Skidmore approached Mr Grill on 13 August 2012. He presented it as a "small albeit a juicy transaction". He proposed a coupon rate of 18 per cent per annum with a minimum return of $1 million irrespective of whether the borrowing period was less than 60 days. Available collateral from Torchlight of some NZD 180 million was referred to.

[16] But Mr Grill was not interested. He made it clear he would not be interested in the transaction at a return of $1 million for 60 days' use of money.

[17] Mr Kerr negotiated a further extension from the Bank, to 22 August 2012. On 17 August Mr Skidmore emailed Mr Grill thus follows:

> John,
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> The last condition on any advance to Torchlight Funds would include an immediate $1m AUD penalty plus any additional interest charges from the Credit Suisse facility in the event that the CS facility is not extinguished on Day 60. For completeness, a further penalty of $1m AUD would be payable each month (to be calculated on a pro rata basis) that for any reason

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7 At [15].

> Torchlight Funds were unable to complete the settlement within the specified 60 day term.
>
> This I believe to be foolproof.

[18] Mr Kerr claimed in evidence that he give no such instruction to Mr Skidmore. But the Judge expressly rejected Mr Kerr's evidence on that point also.[8] In the meantime Mr Grill made enquiries of Credit Suisse to ascertain whether it would lend Wilaci the $37 million in the event a deal could be done with Torchlight. Credit Suisse was prepared to offer him $40 million secured by up to 3.5 million WorleyParsons shares held by Mr Grill and interests associated with him. [9]

[19] On 20 August 2012 Messrs Kerr, Skidmore and Grill met in Sydney. The Judge found that either at that meeting or in an email shortly thereafter Mr Kerr's need to repay the Bank in relation to the RCL Group transaction became apparent.[10] A third transactional strand now emerged: a proposed privatisation of Pine Gould Corporation (PGC) in which Mr Kerr was majority shareholder. This, he suggested, would result in a value uplift of $10 million to be split equally, "so circa 5m each".

[20] Unsurprisingly Mr Grill detected from this that the amount Mr Kerr would be willing to pay was rather more than the $1 million previously on offer. Now it might be more like $5 million. That was in effect confirmed by email from Mr Skidmore. As the Judge put it:[11]

> At this point Mr Grill appears to have decided that the fundamentals of the transaction were acceptable, albeit that what he contemplated was a loan to Torchlight and not an investment in PGC. Whether he chose to "cherry pick" Mr Kerr's offer is, it seems to me, ultimately immaterial although I am inclined to the view that he did. In any event, I find that he was never minded to enter into the transaction for an AUD 1m fee and only at the level of AUD 5m was his appetite for the transaction sufficiently whetted.

[21] By 21 August Mr Grill's position was that a straightforward loan to Torchlight would be acceptable but for a fee of $5 million for a 60 day advance. Mr Kerr was agreeable to that course. However at that point Mr Grill instructed an analyst, a Mr Kurt Jeston, to undertake due diligence of the proposed transaction.

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8 At [25]–[26].
9 Those shares were then valued at approximately $90 million.
10 *High Court Judgment*, above n 2, at [33]–[35].
11 At [39].

The extent of Mr Jeston's enquiries, and the delay associated with that course on the eve of expiry of the latest extension by the Bank, provoked a "somewhat explosive reaction from Mr Kerr". Mr Kerr considered approaching other lenders. That was not realistic in the circumstances. Within the required timeframe, Wilaci was the only realistic lending option. So with what grace he could muster Mr Kerr set about satisfying Mr Jeston's due diligence enquiries.

[22] At that point Mr Jeston sought clarification on the exact return Mr Grill was expecting. Mr Grill's response on 24 August 2012 was:

> I am expecting to recover all my costs of going into the transaction which included legal, financial advice etc, loan set up costs (if any), interest cost on the $37 million (at approx. 5.25%) plus $5 million providing loan is settled in 60 days. Additional $1 million for week or part thereof after 60 days.

[23] Later the same day Mr Skidmore sought to negotiate the suggested $1 million per week penalty down to $100,000 per week. He noted the level of security, with Mr Grill or Wilaci having the ability to appoint a receiver and take over the collateral. As the Judge noted, this was a somewhat optimistic proposal given the earlier offer of $1 million per month in the event of late payment (albeit when the facility fee proposal was $1 million rather than $5 million). Mr Grill responded on 25 August 2012:

> I am concerned that $100k per week doesn't provide enough incentive to make sure the deal gets settled within 60 days. That's why I suggested $1 million. A compromise of say $500k would be ok to me.

[24] Another financial advisor to Mr Kerr, Mr Naylor, responded to Mr Kerr that things were "[s]tarting to get ridiculous … Do we have any viable alternative or are we a price taker?" As to that the Judge found:[12]

> The suggestion that Torchlight was at that stage a "price-taker" was accurate. Repayment to [the Bank] was now significantly overdue. Substantial penalties were being incurred. There was no viable funding alternative within available timeframes.

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12 At [53].

[25] At that juncture Mr Kerr accepted reality. He agreed to Mr Grill's compromise offer. A loan agreement and general security agreement were executed on 27 August 2012, and the money flowed from Wilaci to Torchlight.

The loan agreement

[26] The loan agreement provides for a loan of $37 million for 60 days at an interest rate being the "Credit Suisse cost of funds plus a margin of 150 basis points [1.5 per cent] on a pass through basis from the Vendor to the Borrower". Elsewhere, however, the amount of interest payable is simply fixed at $320,000. It is accepted that that was the interest payable under the loan agreement for the 60 day term, and was to be paid at the same time as repayment of the principal. That is, 60 days after drawdown. In addition a fee of $5 million was payable, but 120 days after drawdown. That is, 60 days after the expected date of repayment of the principal.

[27] So far as default is concerned, the following provisions are relevant. Clause 3.5 of the loan agreement provides:

> If the Borrower does not make any payment (including a payment of interest) on or before its due payment date, interest on the amount unpaid shall be paid by the Borrower at the Default Rate both before and after judgment for the period from the due payment date until the actual date of payment. Default interest will accrue daily, and will be compounded monthly.

And cl 3.8 provides:

> If the Loan is not repaid on the Date of Final Payment, the Late Payment as set out in the Loan Terms will apply.

[28] The "Loan Terms" are found in sch 1 and they provide as follows:

(b)	Default Rate: (per cent per annum)	0.00% above the then current Interest Rate.
(c)	Late Payment fee: (per week)	$500,000, which amount will reduce on a pro rata basis by the equivalent percentage reduction that occurs on any principal repayment of the Loan being made

[29] Non-payment for any reason on the due date constituted an event of default. In that case the agreement, and the security, became immediately enforceable and a discretionary power to cancel the facility arose.

The general security agreement

[30] The general security agreement entered by Wilaci and Torchlight granted Wilaci a security interest (in practical terms a floating charge) over all of Torchlight's property (and which charge would fix upon default). It was, ostensibly, a first ranking priority. Clause 12 empowered Wilaci to take possession of any secured property. Clause 13 empowered it to appoint a receiver when an event of default occurs. There was no personal guarantee by Mr Kerr in support. Nor was there any negative pledge precluding adverse transfer of assets by Torchlight to a third party. Torchlight's financial statements for the period ending 31 March 2013 disclose that Torchlight's assets and liabilities were transferred to another limited partnership registered in the Cayman Islands in December 2012. We were informed from the Bar that these are the subject of separate proceedings brought by Torchlight's receiver. There is apparently a challenge as to whether the general security agreement covers these assets at all.[13]

Torchlight's default

[31] The $37 million principal (together with the $320,000 interest) was due to be paid on 26 October 2012. They were not. As we relate later in this judgment, it is clear that, as a result, Torchlight was then in default.

[32] But that was not the way Mr Kerr characterised the matter back then. Rather he asserted that the loan agreement entitled him to extend payment "to ensure flexibility on term date — albeit at $500k a week".

[33] One of the ironies of this appeal is that Torchlight initially characterised the late payment fee as a continuing facility fee, but now calls it a penalty and denies liability to pay any of it. On the other hand, Wilaci initially described the late

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13 These proceedings are referred to in the judgment of Gilbert J in *Torchlight Fund No 1 LP (In Receivership) v NZ Credit Fund (GP) 1 Ltd* [2014] NZHC 2552 at [9].

payment fee as a "penalty", but now denies that it has that effect.[14] Characterisation by a party of a payment as a "penalty" in the course of negotiation has only modest significance. The real question is whether in substance the repayment has the illegitimate qualities of an unenforceable penalty. What is more, Wilaci's initial (but not primary) argument is that Mr Kerr's original characterisation was correct, so that the late payment fee was no penalty at all.

[34] In the ensuing period from late October to early December 2012 Messrs Grill and Kerr communicated by email. On 10 December Mr Grill emailed Mr Kerr to say that unless he had confirmation of payment of $18.5 million[15] and $320,000 in interest — and an acknowledgement that Torchlight was liable for the late payment 60 days after drawdown — by 18 December 2012, he would be instructing the solicitors to issue a default notice the following day. Mr Kerr immediately replied:

> John
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> 1. We have been incurring the 500K since the 60th day — no issue with that at all.
>
> 2. The day the 5M fee is due is the 27th [of December] so will be payable then.
>
> 3. The interest of 320k we are advised differently — but will check again.
>
> 4. The 18.5m is not subject to any default notice. Are you in disagreement on this issue?
>
> George"

[35] Mr Grill responded, on 11 December 2012, noting it was good that Mr Kerr now acknowledged that the $500,000 a week applied after 60 days and that his previous unwillingness to acknowledge that had been a major point of disagreement. Mr Grill concluded:

> I have been delaying issuing a default notice to give you the chance to make repayments under the loan. I feel after all this time that if you can't make your initial payment on the date you have specified then it is time to issue the default notice.

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14 See above at [17] .
15 Being 50 per cent of the principal due for repayment.

[36] In correspondence Mr Kerr continued to assert that what was being provided was an "equity bridge". That is, bridging finance pending the raising of equity. Furthermore, he was prone to maintain that Wilaci had been paid "valuable consideration for us to own the flexibility". Promises of payment came and went. Mr Skidmore described the period as one of "endless excuses and broken promises" by Mr Kerr. That assessment is not unfair.

[37] The $18.5 million half-payment of principal, and the $320,000 in interest, were not paid on 18 December. The $5 million was not paid on 27 December 2012. Ultimately repayment was achieved in seven tranches, beginning on 1 October 2013 and ending on 2 May 2014.[16] The $320,000 agreed interest sum, the $5 million facility fee, and the accumulating and compounding late payment fees were not paid at all.

[38] On 29 May 2014 Wilaci formally issued demand for payment of $33,628,934. That sum comprised the $5 million facility fee, the $320,000 interest and the late payment fees which then totalled $28,308,934. Payment was not made. On 10 June 2014 Wilaci appointed receivers pursuant to the general security agreement.

[39] Torchlight issued this proceeding on 26 August 2014. Its purpose was to challenge: (1) the $5 million facility fee as unconscionable for the purposes of s 12CB of the Australian Securities and Investment Commission Act 2001 (Cwth) and (2) the late payment fees as an unlawful penalty at common law.

[40] Prior to trial and following the service of a statutory demand, the second respondent arranged for payment of the $320,000 interest sum, together with $1 million plus interest on account of the $5 million facility fee. Wilaci's counterclaim in the proceeding pursued the balance of the facility fee of $4 million plus interest, plus the late payment fees. Immediately before trial Torchlight's challenge to the facility fee and interest was abandoned altogether. Only the late payment fees remained in issue at trial, and on this appeal.

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16 *High Court Judgment*, above n 2, at [59].

Governing law

[41] The loan agreement provides expressly that it is governed by the law of New South Wales. Expert evidence on the law in New South Wales was called by each party at trial. Neither counsel on appeal devoted much attention to the issue of choice of law before us. That is hardly surprising, for two reasons. The first is that the expert evidence was broadly consistent, although there were some distinctions made — particularly as to the significance of a Queensland decision *PT Thiess Contractors Indonesia v PT Arutmin Indonesia*.[17] The second is that, after delivery of Muir J's judgment, the High Court of Australia issued its decision in *Paciocco v Australia and New Zealand Banking Group Ltd*.[18] That decision has given a significantly greater measure of clarity to the doctrine of penalties in Australia.

Issue one: Is the doctrine against penalties engaged?

[42] The essential question underlying issue one is whether the late payment fee is a primary obligation — that is, a payment for further funding accommodation — or a secondary obligation conditional on, and responsive to, default.

[43] As we have noted already, the parties here flipped positions on this question.[19] Initially Torchlight characterised the late payment fee as a continuing facility fee. But now it says it is not, and that it is a penalty. Wilaci called it a "penalty" at one stage of the negotiations; but now it says it is a primary obligation providing "some further accommodation" for Torchlight's funding position.

[44] As will be obvious, this issue raises a question of contractual construction.

The High Court judgment

[45] The Judge observed it was undisputed that a failure to pay on 26 October 2012 gave rise to a breach of the loan agreement and an event of default. There was no option to extend beyond that date.[20] The obligation to pay the late payment fee

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17 *PT Thiess Contractors Indonesia v PT Arutmin Indonesia* [2015] QSC 123.

18 *Paciocco v Australia and New Zealand Banking Group Ltd* [2016] HCA 28, (2016) 333 ALR 569.

19 See [33] above.

20 *High Court Judgment*, above n 2, at [131].

arose on and contemporaneously with breach. It was referable to the breach and collateral to it, rather than existing independently.

[46] The Judge also found compelling Torchlight's argument that it would have been unable to resist a claim brought on 27 October 2012 for repayment of the loan on the basis that the late payment fee "provided for some undefined period of 'flexibility'".[21]

[47] The Judge also found Torchlight's argued construction sustained by the course of negotiations preceding the agreement. The whole premise of the transaction was to ensure Wilaci got its money back within 60 days.[22]

Submissions

[48] This issue, logically first in order of analysis, was advanced as a secondary argument by Wilaci. It was addressed orally only briefly. That might well be thought to reflect due diffidence about its prospects.

[49] Mr Jackson QC (who presented Wilaci's submissions before us) submitted that on the true construction of the loan agreement, the late payment fee was simply a price payable for some further accommodation. The late payment fee was found among other payment provisions in cl 3 of the agreement. It was adjustable according to the amount outstanding — said to be indicative of a price provision. A failure to pay on the due date was an event of default, but the lender was not obliged to enforce. If payment was not made on the due date, the late payment fee simply kicked in. Clause 3.8 should not be treated as a secondary obligation and the Judge erred in finding the late payment fee arose "on and contemporaneously with breach".[23] The absence of a right to extend the loan was not important: the "factual reality" was the loan accommodation would continue regardless of extension or not. As Mr Jackson put it, "[a] de facto loan running on after the due date is no less accommodation because the agreed loan term has expired or because it has not been obtained pursuant to a contractual extension right". Analogy was drawn with other

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21 At [132].
22 At [133].
23 At [131].

contexts: late return of a rental car or release of a hotel room. The payments required for extra time did not represent damages for breach.

Discussion

[50] We do not accept Wilaci's argument on issue one.

[51] In our view it is plain that the late payment fee is to be regarded as a secondary obligation arising on, and responsive to, default. In all respects it fits within the first category articulated by Lords Neuberger and Sumption in *Cavendish Square Holding BV v Makdessi*:[24]

> Thus, where a contract contains an obligation on one party to perform an act, and also provides that, if he does not perform it, he will pay the other party a specified sum of money, the obligation to pay the specified sum is a secondary obligation which is capable of being a penalty; but if the contract does not impose (expressly or impliedly) an obligation to perform the act, but simply provides that one party does not perform, he will pay the other party a specified sum, the obligation to pay the specified sum is a conditional primary obligation and cannot be a penalty.

[52] First, the loan agreement contains a direct obligation on the part of Torchlight to repay the principal on day 60. Clause 3.1 requires the loan to be repaid on the "Date of Final Payment" in Sch 1 — being 60 days after the Date of Advance. The term also is expressly stated to be 60 days. There is no provision whatever for extension, and non-repayment is not a matter of entitlement. The entire point of the transaction had been a short term 60 day bridging facility. It was not a revolving credit agreement.

[53] Secondly, that reality is reinforced by the fact that cl 6.1(a) provides that non-repayment on due date is an event of default. That is, it was a breach of the obligation to repay on day 60. As noted already, the entire loan agreement and security became immediately enforceable without more. Rights of enforcement under the general security deed included the right to seize Torchlight's property and to place Torchlight in receivership. Any indebtedness was now payable on demand.

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[24] *Cavendish*, above n 5, at [14].

That included the $5 million facility fee which was not otherwise due for payment for another 60 days.[25]

[54] Thirdly, it is immaterial that Wilaci did not immediately make demand. The question here is one of construction at the time of entry into the loan agreement. We are not assisted by subsequent conduct to ascertain meaning in this instance. In any event, little assistance is given Wilaci by its own later actions. It soon asserted that an event of default had occurred.[26] Thereafter it appointed receivers to Torchlight's assets.

[55] Fourthly, we record that it is unnecessary in this appeal to examine the point of difference between *Cavendish* and *Paciocco* over whether the doctrine of penalties is confined to substituted obligations imposed on contractual breach.[27] In *Cavendis*h the United Kingdom Supreme Court held it was. That was not the conclusion of the High Court of Australia in *Andrews v Australia and New Zealand Banking Group Ltd*, which held the primary obligation to which the penalty was collateral might not necessarily amount to a breach.[28] Nothing turned on this point in this appeal.

Conclusion

[56] This was not a case where Torchlight's retention of Wilaci's advance was a matter of entitlement, compensable by continued fee payments. Non-repayment of the advance was a breach of Torchlight's plain obligation to make repayment of the advance in 60 days. The late payment fee provision was not a primary obligation, but a secondary obligation conditional on, and responsive to, default. Issue one is answered in the affirmative.

Issue two: Was the late payment fee an unenforceable penalty?

[57] This was the principal issue in the appeal.

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25 See [26] above.
26 See [34] above.
27 *Cavendish*, above n 5; and *Paciocco*, above n 18.
28 *Andrews v Australia and New Zealand Banking Group Ltd* [2012] HCA 30, (2012) 247 CLR 205 at [78]. See also Gageler J in *Paciocco*, above n 18, at [119]–[121].

The High Court judgment

[58] The Judge focussed on the parties' reasons for agreeing to the late payment fee. In particular, Wilaci — which had demanded it. The parties intended to incentivise payment on the due date, as was clear from Mr Skidmore and Mr Grill's email communications. Although Mr Grill may well have calculated that the $500,000 late payment fee was not a materially different return to the $5 million loan fee, that was not his stated purpose in imposing the late payment fee. The fee settled upon was an impost sufficiently draconian to concentrate Torchlight's mind on the importance of timely repayments. As the predominant function of the fee was deterrence, it was an in terrorem obligation and therefore an unenforceable penalty.[29]

[59] By way of alternative analysis, the Judge considered whether the payment was a genuine pre-estimate of loss. He approached this by explicit reference to the *Hadley v Baxendale* remoteness principles.[30] The Judge found that many of the potential losses postulated by Wilaci were never likely to be caused by late payment. Mr Grill would never have entered into this transaction and the related loan with Credit Suisse if there was a realistic possibility that shares pledged as security to Credit Suisse would be lost or reputational harm would result from enforcement action by Credit Suisse.[31] Mr Grill was wealthy and competent in business and only ever pledged a small percentage of his available shares to Credit Suisse. It was an irrelevant and unlikely "doomsday" scenario that Mr Grill's share portfolio might have declined in value as a result of late payment.[32] Further, the Judge considered it was unlikely Wilaci would ever have permanently lost the principal sum of $37 million.[33]

[60] The likely losses, therefore, were confined to Wilaci's ongoing interest costs to Credit Suisse. Those costs were covered by the margin of 1.5 per cent in the loan agreement with Torchlight.[34] The late payment fee therefore so significantly

29 *High Court Judgment*, above n 2, at [170]–[172].
30 At [173] and [176]; citing *Hadley v Baxendale* (1854) 9 Exch 341 at 354.
31 *High Court Judgment*, above n 2, at [178] read with [161].
32 At [179].
33 At [180].
34 At [182].

exceeded the loss likely to be caused by the breach that was extravagant and unenforceable.[35]

[61] The Judge considered a submission that Wilaci's legitimate interest in timely payment was broader than likely losses recoverable as contractual damages. He said that although the inquiry is not mechanical, it must be connected with recoverable damages, otherwise the prohibition on penalties would be illusory and parties would achieve extravagant recovery.[36]

[62] For these reasons, Muir J found the late payment fee was an unenforceable penalty.

Submissions

[63] Mr Jackson's submissions for Wilaci focused on the fact the late payment fee was commensurate with the rate of return agreed for the initial 60 day loan period. The $5 million fee plus $320,000 fixed interest component gave a daily return of $86,667 for the initial 60 day period; the late fee of $500,000 per week gave a daily return of $71,428. It was reasonable for Wilaci to require a continuing rate of return on non-payment as that represented an increase in risk.

[64] The Judge erred, Mr Jackson submitted, in comparing the late payment fee with the loss likely to have been caused by the breach on remoteness principles. The focus under *Paciocco* instead must be on a comparison with the lender's legitimate interests, which may be greater than an interest in compensation for loss. Wilaci had an interest in only exposing itself to the high level of risk this transaction represented if the return was high, and in continuing to receive a high level of return after default at 60 days. It also had other legitimate interests, which were supported by the late payment fee and for which either the general interest rate of 1.5 per cent above the Credit Suisse rate, or damages for breach based on numbers of that order, would be inadequate. These included enhancing the prospect its risk would be confined to the 60 day period, ensuring it could reinvest in other things thereafter, maintaining its

35 At [187].
36 At [189].

asset base, having available commercial alternatives to enforcement steps after the due date and averting loss of the secured shares and reputational damage.

[65] For Torchlight Mr Stewart QC submitted the comparison should be with damages recoverable at law. Kiefel J in *Paciocco* said that remains a useful guide when assessing whether the clause is a penalty.[37] On this approach, Wilaci's likely loss was its interest obligations to Credit Suisse, which was fully compensated by the default interest rate provision. The late payment fee was approximately 19 times that amount and therefore exorbitant.

[66] The other potential losses identified were fanciful. Wilaci never pledged more than 18 percent of its shares to Credit Suisse as security. The total sum of the loan was less than 5 per cent of Mr Grill's estimated wealth of $780 million. He was capable of paying the Credit Suisse loan from other sources or refinancing the loan, so he would never conceivably have lost his shares. Compared with *Paciocco*, where ANZ identified concrete losses on late payment of credit cards, the losses here were speculative. The late payment fee was not fixed by reference to Wilaci's likely losses.

[67] It was a misconception to say Wilaci had lost the opportunity to charge a fee of $5 million for each subsequent 60 day period. Wilaci was not in the business of making loans. It would not have continued to make loans in that manner, to Torchlight or anyone else. Wilaci had not identified what else it might have done with the $37 million principal had it been paid on time, such that any opportunity loss was calculable.

Development of the penalties doctrine

[68] The history of the penalties doctrine is analysed at length by the United Kingdom Supreme Court in *Cavendish* and the High Court of Australia in *Paciocco*.[38] As Lords Neuberger and Sumption observed in the former, the penalty

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37 *Paciocco*, above n 18, at [33].
38 *Cavendish*, above n 5; and *Paciocco*, above n 18.

rule "is an ancient, haphazardly constructed edifice which has not weathered well".[39] The following salient aspects of the early development of the doctrine may be noted.

[69] Equity, where the doctrine first emerged, restrained actions to enforce defeasible bonds where the true intent inferred was that the bond served as security only for payment of the primary obligation. Such a bond would involve the borrower executing an instrument for a sum typically twice the sum lent, binding the borrower to pay the lender the larger sum on a fixed day, with the proviso that if payment of the lesser sum lent was first made, the bond would become void.[40] By the second half of the 17th century equity would invariably view the greater sum as penal and award relief upon payment of the lesser sum plus costs and interest. The true nature of the obligation to pay the penalty was securing and secondary. The equitable doctrine was inapplicable where damages were not readily assessable, and developed alongside equitable relief against forfeiture in mortgages and leases.[41] Equitable relief for penalties logically should be viewed now through the modern lens of unconscionability.

[70] Common law began to offer relief on the same terms, and statutes passed in 1697 and 1705 regularised the position.[42] Common law's initiative drew on its equitable competitor. But its constraint on penalties was based on public policy objections that punitive provisions in contract should not be given effect at all.[43] The remedial function of the common law of contract was confined to the achievement of performance expectations. Enforcing punishments formed no part of that.

[71] The leading decision for a century has been *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd*.[44] We will come to *Dunlop* in a moment. But prior to *Dunlop* the leading English authority was *Clydebank Engineering and Shipbuilding Co Ltd v Yzquierdo E Castaneda*.[45] In *Clydebank* the Spanish Government had

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39 *Cavendish*, above n 5, at [3] (Lord Carnwath agreeing).
40 See AWB Simpson "The Penal Bond with Conditional Defeasance" (1966) 82 LQR 392 at 395.
41 AWB Simpson *A History of the Common Law of Contract* (Clarendon Press, Oxford, 1975) at 118 and 120–121.
42 C J Rossiter *Penalties and Forfeiture* (Law Book Company, Sydney, 1992) at 11.
43 *Cavendish*, above n 5, at [7]; *Paciocco*, above n 18, at [253]–[254].
44 *Dunlop*, above n 5.
45 *Clydebank Engineering and Shipbuilding Co Ltd v Yzquierdo E Castaneda* [1905] AC 6 (HL) [*Clydebank (HL)*].

contracted with the appellant shipbuilder for the construction of four torpedo boats at prices between £65,650 and £67,180 per vessel. The contracts provided fixed delivery dates, with provision of a "penalty for later delivery … at the rate of £500 per week for each vessel".[46] Delays totalling 135 weeks ensued, and damages of £67,500 were sought. The shipbuilder claimed the penalty was not a true calculation of liquidated damages but a penalty in the strict sense and recoverable only to the extent actual loss was proved by the Spanish Government. On that basis, the only damages would be some £3,126 for delivery crew accommodation and other sundries. At first instance in the Court of Session, the Lord Ordinary expressed the governing principle thus:[47]

> [T]hat in determining the true character of something called penalty, or something called liquidate damage, it was an important, and perhaps conclusive, consideration that the amount of the so-called penalty, or of the so-called liquidated damage, was on the one hand reasonable and moderate, or on the other hand exorbitant and unconscionable. *Prima facie* of course the parties were the best judges of that matter. Still the amount stipulated might be such as to make it plain that it was merely stipulated *in terrorem*, and could not possibly have formed a genuine pre-estimate of probable or possible damage, or, to speak perhaps more correctly, a genuine pre-estimate of the creditor's probable or possible interest in the due performance of the principal obligation.

Applying that principle the Lord Ordinary concluded that the shipbuilders had failed to show that the £500 per week was exorbitant and unconscionable.

[72] That same reasoning in essence prevailed in the House of Lords when Lord Halsbury LC considered jurisdiction lay to interfere where the agreement was "unconscionable and extravagant, and one which no Court ought to allow to be enforced".[48] None of the Law Lords sought to lay down what the Lord Chancellor called an "abstract rule", or series of tests, to demonstrate whether the contract was extravagant or unconscionable.[49] Lord Davey saw the test as whether the clause provided "a penalty strictly so called in the sense of punishment irrespective of the

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46 *Clydebank Engineering and Shipbuilding Co Ltd v Yzquierdo E Castaneda* (1903) 5 F 1016 (Ct of Sess) at 1017 [*Clydebank (Ct of Sess)*].
47 *Clydebank (Ct of Sess)* above n 46, at 1022.
48 *Clydebank (HL)*, above n 45, at 10.
49 At 10.

damage sustained".[50] Lord Robertson, the third member of the Board, expressed the principle in terms referred to with approval over a century later in *Cavendish*:[51]

> Now, all such agreements, whether the thing be called penalty or be called liquidate damage are, in intention and effect what Professor Bell calls "instruments of restraint," and in that sense penal. But the clear presence of this element does not in the least degree invalidate the stipulation. The question remains, [h]ad the respondents no interest to protect by that clause, or was that interest palpably incommensurate with the sums agreed on?

[73] In that case the torpedo boats were not required for commercial purposes; the loss sustained by a nation state from delayed delivery of a warship did not "admit of precise proof or calculation" and it was entirely reasonable that the parties reach agreement of their own as to the appropriate measure of compensation in the event of delay.[52] The provable direct costs of delay (for example, accommodating crew pending delivery) were not to be substituted for what the parties had themselves agreed.

Doctrine diverted: Dunlop

[74] We turn now to *Dunlop*. It concerned a wholesale supply contract for tyres and related products. The contact contained list price maintenance provisions to protect the manufacturer and prevent discounting. One clause provided that £5 had to be paid for every product sold in breach of the agreement — for example, at a discount.[53] The clause was held not to be an unlawful penalty, essentially because the provision contained "nothing unreasonable, unconscionable, or extravagant" given potential injury to Dunlop's trade interests by price cutting and the difficulty of proving the exact measure of damages as a result.[54]

[75] The case is best known for Lord Dunedin's speech which expounds four tests to resolve the question of whether a sum stipulated to be paid upon breach is a "penalty or liquidated damages".[55] As Lords Neuberger and Sumption observe in *Cavendish*, that speech "achieved the status of a quasi-statutory code" in ensuing

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50 At 15.
51 At 19 and 20.
52 At 20.
53 The tyre product sold in breach had a list price of £4 1s, and had been sold at a nine shilling discount.
54 See for example *Dunlop*, above n 5, at 97 per Lord Atkinson.
55 At 86.

case law, a development they describe as "unfortunate" and resulting in the law becoming "the prisoner of artificial categorisation".[56] And as Gageler J noted in *Paciocco*, "the unintended consequence of lucidity is sometimes rigidity".[57]

[76] The principal difficulty created by *Dunlop* is in Lord Dunedin's first test, which is that a sum "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 flowed from the breach".[58] The consequence of this test — in effect later treated as a rule — has been countless attempts by parties alleging penalty to contrast the payment required on default with the alternative remedy of damages for breach that might be found absent the clause, with any prospective excess said to found an illegality ab initio. Yet as Lords Neuberger and Sumption observe in *Cavendish*, the other Law Lords in *Dunlop* did not expressly agree with Lord Dunedin's approach. And to that observation might also be added the fact that Lord Dunedin did not himself apply his own tests in any close fashion. Rather he simply concluded:[59]

> It is just, therefore, one of those cases where it seems quite reasonable for parties to contract that they should estimate that damage at a certain figure, and provided that figure is not extravagant there would seem no reason to suspect that it is not truly a bargain to assess damages, but rather a penalty to be held in terrorem.

[77] Lord Atkinson emphasised the legitimate interests of Dunlop in preventing disorganisation of its trading system, the clause containing "nothing unreasonable, unconscionable or extravagant".[60] And Lord Parmoor too remained consistent with *Clydebank* in saying:[61]

> No abstract rule can be laid down without reference to the special facts of the particular case, but when competent parties by free contract are purporting to agree a sum as liquidated-damages there is no reason for refusing a wide limit of discretion. To justify interference there must be extravagant disproportion between the agreed sum and the amount of any damage capable of pre-estimate.

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56 *Cavendish*, above n 5, at [22] and [31].
57 *Paciocco*, above n 18, at [152].
58 *Dunlop*, above n 5, at 87.
59 *Dunlop*, above n 5, at 88.
60 At 97.
61 At 101.

[78] As must be obvious from these passages, the question of whether the stipulation was a penalty was not to be resolved by a simplistic contrast between the collateral obligation now due and the maximum amount that might instead be recovered by way of damages for breach. And that is obvious in any case from the particular breach that propelled the proceeding in *Dunlop*: the sale of a tyre cover at nine shillings below a list price, resulting in the collateral obligation to pay an amount more than 11 times the illicit discount.

Doctrine redirected: Cavendish *and* Paciocco

[79] The deficiencies in *Dunlop*, or at least in its subsequent treatment, were exposed in length in the United Kingdom Supreme Court decision in *Cavendish*.[62] That decision encompassed two appeals. *Cavendish* itself concerned the sale of a majority interest in an advertising agency for a consideration approaching USD 147 million. A non-competition covenant was given by the vendors. In the event of breach, any outstanding price would no longer be payable and the purchaser had the right to acquire the remaining shares at a discounted price (in effect free of goodwill). The vendors breached the covenant and the purchaser sought to enforce the rights on breach. The vendors alleged these collateral obligations were penal, a contention rejected by the High Court, accepted by the Court of Appeal and again rejected by a unanimous Supreme Court. The other appeal, *ParkingEye Ltd v Beavis*, was at the other end of the commercial spectrum: a motorist had overstayed a two hour free parking licence provided by a shopping centre — by 56 minutes — and was (in accordance with signs clearly displayed) charged a further £85 by the parking management company. Mr Beavis' contention that the fee was an unlawful penalty was rejected in the County Court, Court of Appeal and Supreme Court (Lord Toulson dissenting).

[80] The following observations in the judgments seem to us germane. First, as Lord Mance particularly observed, the dichotomy which Lord Dunedin concerned himself with between penalty and legitimate liquidated damages is a false one — or at least not exclusive. Rather, "there may be interests beyond the compensatory

[62] *Cavendish*, above n 5.

which justify the imposition on a party in breach of an additional financial burden".[63] As Lords Neuberger and Sumption put it:[64]

> The real question when a contractual provision is challenged as a penalty is whether it is penal, not whether it is a pre-estimate of loss. These are not natural opposites or mutually exclusive categories. A damages clause may be neither or both.

[81] Secondly, *Cavendish* reinstates the pre-*Dunlop* focus on whether the substituted obligation is unconscionable or extravagant (said usually to amount to the same thing).[65] The test proposed by Lords Neuberger and Sumption (with whom Lords Carnwath and Clark agreed) was:[66]

> [W]hether 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.

Lord Mance was of similar opinion in inquiring first as to what legitimate business interests are served and protected by the clause and then whether the provision made by the clause impugned is "extravagant, exorbitant or unconscionable".[67] Not dissimilar formulations appear in the judgments of Lords Hodge and Toulson.[68] As Lord Hodge put it, "the criterion of exorbitance or unconscionableness should prevent the enforcement of only egregious contractual provisions".[69]

[82] Thirdly, consistent with authorities in the more modern doctrine of unconscionability, relevant considerations include whether both parties are commercially astute, have relatively similar bargaining power and are advised. In such a case, as Lords Neuberger and Sumption put it, "the strong initial presumption must be that the parties themselves are the best judges of what is legitimate in a provision dealing with the consequences of breach".[70]

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63 *Cavendish*, above n 5, at [152].
64 At [31].
65 At [32], [152] and [293].
66 At [32].
67 At [152].
68 At [255] and [293].
69 At [266].
70 At [35]. See also Lord Mance at [152].

[83] Fourthly, the fact that a clause substituting one scale of performance for another is designed to deter breach of the former does not mean it is penal. As Lord Hodge noted, many (legitimate) contractual provisions are coercive in nature.[71]

[84] We turn now to the later decision of the High Court of Australia in *Paciocco*.[72] As we have already noted, this decision also post-dated delivery of the judgment under appeal here. The appeal concerned a fixed late payment fee provision in consumer and business credit card accounts provided by a trading bank. Credit card customers were required to pay a minimum amount of the monthly balance by a certain date. If they did not do so they would be charged a fixed fee of either $20 or $35 (in addition to interest). There was no suggestion that these amounts were any sort of pre-estimate of loss due directly to the customer's default. Applying *Dunlop*, the Federal Court held the late payment fee to be penal and unenforceable. That was because the fee bore no relation to the direct cost of recovery of the outstanding amounts, which the Judge at first instance held to be the only relevant comparable compensation. The Full Court of the Federal Court allowed the bank's appeal, admitting other evidence of adverse financial impact of late payment on the bank. Mr Paciocco's appeal was dismissed by the High Court of Australia (Nettle J dissenting).

[85] The following aspects of the principal majority judgments may usefully be restated.[73]

[86] First, putting aside the question of whether the doctrine is now confined to cases arising out of breach of contract only, the approach taken in the judgments in *Paciocco* are consistent with (and draw upon) those in *Cavendish.*

[87] Secondly, the justification for the rule against penalties lies in an amalgam of Equity and the common law rule based on public policy. Its essential justification, in the face of the usual (and commercially important) principle of freedom of contract, is that a provision that has its sole or predominant purpose is to punish a contract

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71 At [248].
72 *Paciocco*, above n 18.
73 French CJ delivered a short judgment concurring with the reasons given by Kiefel J.

breaker is contrary to public policy.[74] As Keane J noted, the courts have consistently refused to countenance the enforcement of attempts to impose punishment by contract as a sanction for non-performance. Rather, the purpose of the law of contract is to satisfy performance expectations.[75] It follows that the test for a penalty cannot simply involve a narrow comparison between contractually stipulated and alternative court-imposed damages. Only a gross disproportion compels the inference that the substituted obligation is really "punitive". The threshold, necessarily, is high.[76]

[88] Thirdly, the fundamental question to be addressed, as Kiefel J observed, is whether the substituted obligation is "out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation".[77] That formulation had also been applied by the High Court of Australia more than a decade earlier in *Ringrow Pty Ltd v BP Australia Pty Ltd*.[78] Keane J also drew on *Cavendish*, but instead on the test suggested by Lord Hodge of whether the substituted obligation "is exorbitant or unconscionable when regard is had to the innocent party's interest in the performance of the contract".[79] In combination those observations express the rule in the law of New South Wales which we must apply. The judgment of Gageler J has a somewhat different emphasis, focussing on whether the exclusive *purpose* of the clause was to punish, in order to deter breach. To that extent Gageler J was in disagreement with Lord Hodge in *Cavendish* who rejected the relevance of the question of whether the secondary obligation was "in terrorem". To Gageler J "the description captures the essence of the conception to which the whole of the analysis is directed".[80] Yet the approach of Gageler J is not so far removed from that of the other members of the majority:[81]

> The relevant indicator of punishment lies in the negative incentive to perform being so far out of proportion with the positive interest in

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74 *Paciocco*, above n 18 at [17] and [22] per Kiefel J, [157]–[159] per Gageler J, and [221] and [253]–[254] per Keane J.

75 At [254].

76 At [156] per Gageler J; [220], [250] and [251] per Keane J.

77 At [54] and [57], adopting the test suggested by Lords Neuberger and Sumption in *Cavendish*, above n 5.

78 *Ringrow Pty Ltd v BP Australia Pty Ltd* [2005] HCA 71, (2005) 224 CLR 656 at [32].

79 *Paciocco*, above n 18, at [270].

80 At [165].

81 At [164].

> performance that the negative incentive amounts to deterrence by threat of punishment.

[89] Fourthly, applying these principles, the bank's late payment fees were not penal in nature. On the evidence, late payments adversely affected the bank's economic interests through added operational costs, loss provisioning and regulatory capital costs. All represented commercial interests by the bank in ensuring legitimate commercial interest by the bank and ensuring its credit card customers made their minimum monthly payments on time. In extent, these costs were not grossly disproportionate so that the sole or predominant purpose of the provision was punitive.[82]

Application

[90] We are satisfied that, measured by these principles, the late payment fee in the Wilaci and Torchlight loan agreement is not a penalty. We start by noting four points of context.

[91] First, the commercial context of the transaction. Both parties were substantial commercial entities. Each was economically astute. Each was independently advised. The transaction was negotiated over a period of weeks. There was no disparity of bargaining power. Compelling reason would be needed why ordinary principles of freedom of contract should not apply to such parties. These facts, and that Wilaci was not in the business of lending, put this case in a very different category from consumer transactions.

[92] Secondly, each party stood to make substantial returns in consequence of the agreement. In Torchlight's case, that gain was collateral to the agreement and evidently substantial. In Wilaci's case the gain was the consideration under the agreement. That was primarily the very substantial facility fee, the legitimacy of which is uncontested. The total cost of credit to Torchlight, as we will note next, was extremely high.

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82 At [68] per Kiefel J, [176] per Gageler J, and [279] per Keane J.

[93] Thirdly, as Mr Symonds observed, the transaction involved, on the other hand, exceptionally high risk to the lender, Wilaci.[83] It was unbankable except by lenders of last resort. Repayment would likely depend on further capital raising.[84] Wilaci was not in the business of lending, and did not have a loan book across which risk could be spread. Given those facts, the rate of return necessarily would be substantial. The total cost of credit for the 60 day period was $5.32 million — for a loan of $37 million. Daily, a cost of credit of $88,667. Annualised, a cost of credit of 87.46 per cent. Such were the risks, and rewards, of the transactions. Torchlight's claim that the $5 million facility fee was unconscionable and a breach of s 12CB of the Australian Securities and Investment Commission Act was abandoned shortly before trial. Torchlight accepted it was not unlawful.

[94] Fourthly, in contrast it may be noted that the late payment fee of $500,000 per week represented a daily cost of credit of $71,428. At first sight, it is unusual that a default credit cost is lower than the equivalent credit cost of the primary transaction. The norm is that on default the cost of credit rises, for two reasons. The first is that the margin encourages due repayment. The second is that default usually signifies a material increase in risk.

[95] Against that background the question issue two poses is whether the late payment fee is out of all proportion to any legitimate interest of Wilaci in due repayment in 60 days. We cannot conclude that it is or, to put it another way, that the predominant purpose of the late payment fee is to punish.

[96] First, the relevant inquiry is not what damages Wilaci might have received had it sued on the primary obligation alone. That is the false dichotomy that developed through an over-rigid application of Lord Dunedin's first test. Following *Cavendish* and *Paciocco*, that question has only limited relevance, and then largely only in cases of ordinary consumer lending.

[97] Secondly, nor is the inquiry whether the late payment fee is simply intended to deter default. In part it is bound to have that purpose. But so too would an

[83] See [13] above.
[84] See [10]–[13] above.

ordinary increased default interest rate or the commonplace provision that default causes all outstanding obligations to fall due. Neither of those are penalties. Deterrence remains relevant inasmuch as *Paciocco* makes clear that where the predominant (Gageler J would say, sole) purpose of the cause is to punish default, it is an unlawful penalty. But the analysis permits deterrence to a degree, which is why older formulations talked of "in terrorem" punishment. It is a perfectly legitimate interest of a contracting party to provide terms that encourage due performance (for example a discount for early payment) or discourage default in performance (the examples just given).[85]

[98] Thirdly, the legitimate interests of the lender will reflect a raft of considerations, including the value of the credit they provide, in the market in which it is provided, the level of risk to the borrower both before and after default (which are likely to differ), costs of recovery, and opportunity and reputational costs (if any). The best measure of these considerations is the worth parties of even bargaining strength place on them in the transaction in issue. Even if the value of credit provided is assumed to be unchanged, the effect of default is normally to place a premium on the legitimate cost of credit post-default because of the other factors just enumerated.

[99] Fourthly, we think the appropriate measure of Wilaci's interest in this transaction is to consider the total cost of credit assuming due performance, and contrast that with the cost of credit imposed post-default. To separate out the facility fee and treat it as a wholly distinct element of consideration is artificial. And it is a false supposition that it might be treated as attributable to borrowing for a term greater than 60 days. It was the core credit cost payable on the assumed 60 day due performance. The proper contrast is not, therefore, between the $320,000 ordinary interest rate payable for eight and a half weeks' borrowing and the $500,000 late payment fee payable weekly post-default. The correct contrast is that set out at [95]–[96] above. The distinctive feature in this case, then, is that the loan agreement in fact provides a *reduced* cost of credit post-default. And it does so despite the extreme level of risk (regardless of the palliative security provided) which was further exacerbated by default.

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85 See also [83] above.

[100] Fifthly, viewed thus, the late payment fee cannot be regarded as penal. It is neither out of all proportion to the legitimate interests of Wilaci as the parties themselves assessed them in the loan agreement, nor predominantly intended to punish Torchlight.

[101] Sixthly, we reach that conclusion as a matter of construction of the loan agreement assessed (as it must be) at the time it was agreed. As was observed in *Cavendish*, it is the character of the provision, rather than the circumstances in which it falls to be enforced, that matters.[86] For that reason we put to one side the evidence of Torchlight's initial stance post-default that the late payment fee created a revolving credit contract, a stance that might otherwise be thought to be insightful as to the character of the late payment fee as non-penal.

Conclusion

[102] In its particular commercial context, and measured by the values the parties themselves placed on the facility, the late payment fee is not out of all proportion to the legitimate interest Wilaci had in due repayment of that facility. Its predominant purpose was not to punish Torchlight. It is not an unlawful penalty. Issue two is answered in the negative.

[103] The consequence is that Torchlight's late payment fee indebtedness ends up nearly as much again as the principal it borrowed and eventually repaid. That is the direct result of it not repaying the principal fully for 19 months and (with clear appreciation of the risk) litigating the late payment fees rather than paying them. The scale of debt it now faces is in large measure a consequence of choices Torchlight made for itself.

Result

[104] The appeal is allowed.

[105] The High Court judgment is varied by deleting Order 2(a) and substituting therefor the following:

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86 *Cavendish*, above n 5, at [9].

> "(a) Judgment against the plaintiff and the counterclaim defendant, jointly and severally, for AUD 31,477,194 being the late payment fees owing as at 31 July 2015 under clause 3.8 and paragraph (iv)(c) of Schedule 1 of the loan agreement plus interest thereon from 1 August 2015 and accruing daily and compounded monthly in accordance with clause 3.5 to the actual date of payment."

[106] The respondents are to pay costs on a standard appeal on a band A basis together with usual disbursements.[87]

[107] Costs in the High Court are to be dealt with in that Court, in accordance with this judgment.

Solicitors:
Lowndes, Auckland for Appellant
Gilbert Walker, Auckland for Respondents

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87 We record that this was the costs order sought by the appellant.