IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2014-404-2136
[2015] NZHC 2559

UNDER	the Receiverships Act 1993
BETWEEN	TORCHLIGHT FUND NO.1 LP (IN RECEIVERSHIP) Plaintiff
AND	KARE JOHNSTONE, WILLIAM GUY BLACK AND JASON PRESTON First Defendants
	WILACI PTY. LIMITED Second Defendant
	NZ CREDIT FUND (GP) 1 LIMITED Counterclaim Defendant

Hearing:	24-28, and 31 August 2015 Further memoranda received 7 September 2015
Appearances:	R B Stewart QC, S M Hunter and A Ho for the Plaintiff and Counterclaim Defendant N S Gedye QC M W McCarthy for the Second Defendant.
Judgment:	19 October 2015

RESERVED JUDGMENT OF MUIR J

This judgment was delivered by me on Monday 19 October 2015 at 4.30 pm pursuant to Rule 11.5 of the High Court Rules.

Registrar/Deputy Registrar

Date:…………………………….

Counsel/Solicitors:
R B Stewart QC, Barrister, Auckland
S M Hunter, Gilbert Walker, Auckland
A Ho, Gilbert Walker, Auckland
N S Gedye QC, Barrister, Auckland
M W McCarthy, Lowndes Associates, Auckland

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Introduction

[1] This is a case primarily concerned with the law relating to penalties. It arises out of a short term loan of AUD 37m by interests associated with a high net worth Australian individual to a New Zealand based private equity fund with urgent cash requirements. That loan has since been repaid. But delays in doing so and an AUD 500,000 per week "Late Payment fee" have resulted in an alleged liability to the lender in excess of AUD 30m. In addition, the lender claims its own cost of funds (having secured back to back funding from Credit Suisse), interest as stipulated in the Loan Agreement and in excess of NZD 1m for receivers' costs and disbursements. The borrower seeks a declaration that the Late Payment fee comprises an unenforceable and irrecoverable penalty.

[2] Shortly before trial, additional claims by the borrower that the lender acted unconscionably in breach of s 12CB of the Australian Securities and Investment Commission Act 2001 (Commonwealth) (the ASIC Act) by imposing an AUD 5m facility fee for the transaction, were abandoned. The borrower admits liability for that fee and interest on all outstanding sums from time to time under the Loan Agreement.

[3] Throughout this judgment I will refer to the plaintiff borrower as Torchlight and the second defendant lender as Wilaci.

[4] An added complexity to the case is that the relevant law (except as otherwise agreed by the parties) is that of New South Wales (NSW) in respect of which extensive expert evidence was called.

Background

[5] This is explained in some detail because of the importance of all of the circumstances under the relevant Australian authorities.

[6] Torchlight is a private equity fund which was established in 2009 to invest in distressed assets. It is no longer active having transferred those assets to a Cayman Islands' entity.

[7] The counterclaim defendant is the general partner of Torchlight and as such is jointly and severally liable for the unpaid liabilities of Torchlight pursuant to s 26 of the Limited Partnerships Act 2008. Mr George Kerr, who was Torchlight's principal witness of fact, is a director of the general partner. At the time his interests were also majority shareholders in Pyne Gould Corporation (PGC).

[8] In mid-2012 Torchlight was in what Mr Kerr described as a "very tight liquidity situation". One of its investments involved the purchase of debt owed by RCL Group (an Australian Real Estate Company) to Bank of Scotland International (BOSI). The purchase price was approximately AUD 185m, of which Torchlight had paid all but AUD 37m by mid-2012. The balance was due on 17 August 2012. This in itself involved an extension from the agreed contractual repayment date of 23 July 2012.

[9] By mid-2012 BOSI was in the final stages of exiting its investments in Australasia following difficulties which it had itself encountered arising out of the Global Financial Crisis (GFC). The Torchlight receivable was one of the last assets to be realised. Mr Kerr anticipated that, in the absence of repayment by due date, BOSI was likely to take prompt enforcement action. Torchlight did not have the cash available to make the required payment. Mr Kerr's evidence was that it planned a capital raising but required short term bridging finance to get it through. Unacknowledged by Mr Kerr at the time was the impact a recent and high profile dispute involving the Financial Markets Authority (FMA) had had on his ability to recapitalise Torchlight. In the final analysis no such capital raising was undertaken before it became inactive.

[10] To meet Torchlight's liquidity requirements Mr Kerr turned to Mr Andrew Skidmore, a financial investment consultant, now based in Singapore but formerly employed by Macquarie Bank in Sydney. Mr Kerr and Mr Skidmore had been acquainted since approximately 2010 and Mr Skidmore says they developed a good working relationship over several different projects. The two knew each other well, to the extent that in 2012 Mr Kerr made an AUD 50,000 advance to Mr Skidmore (from the so-called Torchlight No 2 Fund) to assist him with temporary liquidity requirements. Arrangements were made by Mr Skidmore to bill Torchlight (GP (2)

Limited) in that amount for advisory services which Mr Skidmore says he provided. Mr Skidmore also says that around this time he was invited by Mr Kerr to become a director of a limited partnership called White LP but this did not eventuate.

[11] Mr Kerr was aware that Mr Skidmore had previously sourced what was initially a NZD 20m loan from interests associated with Mr J M Grill, a wealthy Australian engineer, businessman and founder of the publicly listed WorleyParsons Limited. This had been to a New Zealand farmer named Alan Pye who needed finance to assist with his shareholding arrangements in Dairy Holdings Limited (DHL). Mr Skidmore had been involved in introducing these loans to Mr Grill and Wilaci, the corporate trustee of Mr Grill's Serpentine Trust.

[12] Mr Skidmore's evidence was that the first he heard of Mr Kerr's requirements was by way of a text received when he was in Los Angeles en route back to Australia. He says that he and Mr Kerr frequently communicated by text and that the message sought assistance in promptly raising money, with an inquiry whether this "is one for Mr Grill" or words to that effect.

[13] The parties met shortly afterwards in Sydney with Mr Kerr's financial advisor Mr Naylor also present.

[14] There is a conflict in the evidence between Mr Kerr and Mr Skidmore as to whether, at this first meeting, Mr Kerr identified that Torchlight's cash requirements were to meet its commitments to BOSI. Mr Skidmore says that the explanation Mr Kerr gave was that he wanted to re-domicile the Torchlight fund from New Zealand to Australia and that he needed third party finance to achieve this. He says Mr Kerr stated that the banks would not provide the funding necessary and that his requirement was for a short term facility only. He also says that Mr Kerr spoke of wanting to buy all of the PGC shares which he did not already own and that he planned to de-list PGC and privatise it as part of a plan to quit New Zealand entirely. This was explained as related to the recent difficulties which PGC's subsidiary Perpetual Trust had had with the FMA.

[15] Mr Kerr says that he told Mr Skidmore at the outset that the AUD 37m was required to repay BOSI. I prefer the evidence of Mr Skidmore in this respect. It is consistent with the stated reason for the loan referred to in Mr Skidmore's first communications with Mr Grill (where Mr Skidmore refers to an investment company "domiciling out of New Zealand" for which he has been asked to execute a strategy), and, in my assessment, Mr Kerr was at this early stage playing his cards as close to his chest as possible to protect his negotiating position. To accept Mr Kerr's evidence would mean that he and Mr Skidmore then deliberately colluded in a false explanation of why the funding was required to Mr Grill. Given the nature of Mr Skidmore's relationship with Mr Grill I am not prepared to find that.

[16] Mr Skidmore deposes that there was some discussion at the meeting about the amount of money required, with Mr Kerr initially stating that he needed AUD 24-26m, and Mr Skidmore advising he should seek the maximum sum possibly needed as it was always undesirable to go back and ask for more. It was agreed that AUD 37m should be sought and Mr Skidmore says that his brief was to find a solution and negotiate the terms of a finance facility.

[17] From the outset Mr Skidmore identified Mr Grill as the preferred lender. He saw the proposition as well outside financing and banking norms and that the prospects of success probably lay only with persuading a wealthy individual like Mr Grill to become involved.

[18] Mr Skidmore's first communication with Mr Grill was by email on Monday 13 August 2012. The subject line was "Small albeit juicy transaction". He said, consistent with my finding in [15] above, that the deal "is a straight facilitation of a re-domiciling of a company from New Zealand to Australia". The amount of the loan was specified as AUD 37m, the term as between 21 and 60 days and the coupon rate 18 per cent per annum "with a minimum return to JMG of $1m irrespective of whether or not the time period is less than 60 days". Collateral was stated to be a multiple of the AUD 37m advance "to be discussed". The email contemplated that the advance would, in turn, be sourced from borrowings which Mr Grill could secure against WorleyParsons Limited shares. He inquired whether Mr Grill was around the following day.

[19] Mr Grill responded later on 13 August suggesting Wednesday 15 August 9.30 am at his office. That meeting duly took place and, later that day, Mr Skidmore followed up with an email suggesting that he had a "solution that guarantees $37m to be called in 59 days and payable on the 60th day", with an "18 per cent pro rata coupon paid up front for the 60 day period". A second meeting was proposed at 10.00 am the next morning which occurred. Later on 16 August Mr Skidmore emailed Mr Grill detailing what he described as his "foolproof structure" to facilitate what he described as "the re-domiciling and roll up of the Torchlight Fund No 1 Limited Partnership to the Torchlight Fund No 2 Limited Partnership". He identified collateral which he said had a value of circa NZD 180m, said that, with the re-domiciling, Mr Grill's security would transfer to the Torchlight Fund No 2 LP and that such fund had committed but not called contributions of AUD 150m "which you will have an automatic call upon on Day 59".

[20] The email contains two references to Credit Suisse consistent with the understanding that it would be the ultimate source of Wilaci's funding for the transaction. Again the email proposed a meeting earlier the following day.

[21] Nine minutes later Mr Skidmore followed that email up with another to Mr Grill confirming the coupon rate of 18 per cent per annum "on a pro rata basis for the 60 day term with a minimum coupon in dollar terms of $1m AUD". He also confirmed that the cost of funds provided by Credit Suisse would in turn be paid by Torchlight. Again the email emphasised repayment on the 60th day. The facility would be "paid out and extinguished" at that time. A little over an hour later Mr Skidmore sent a further email identifying an additional advantage of the transaction in terms that "Torchlight will not compete with you for any additional DHL shares" giving Mr Grill the ability to take control of DHL at a "discounted value". In his evidence Mr Grill said that none of this was of any interest to him given limitations on his ability to hold shares in DHL absent Overseas Investment Commission (OIC) approval.

[22] Mr Skidmore's evidence was that, as at the evening of Thursday 16 August, Mr Grill had not shown any enthusiasm for the transaction and, indeed, had made it

clear that he would not be interested in it at a proposed return of AUD 1m for 60 days.

[23] The next morning, on 17 August, at 7.08 am, Mr Skidmore again emailed Mr Grill. The terms of the email are significant and are set out in full below.

> John,
>
> The last condition on any advance to Torchlight Funds would include an immediate dollars $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 AUD 1m would be payable each month (to be calculated on a pro rata basis) that for any reason Torchlight Funds were unable to complete the settlement within the specified 60 day term.
>
> This I believe to be foolproof.

[24] The reference to "foolproof" in this context mirrored earlier references in the same terms and, in my view, was directed to assuring Mr Grill (or as Mr Skidmore said on 15 August "guaranteeing") that repayment would be made on the 60th day, by virtue of a substantial "penalty" if default occurred.

[25] There was significant conflict in the evidence between Mr Kerr and Mr Skidmore as to whether this email was sent on the instructions of Mr Kerr. Mr Skidmore's evidence was that, because the proposal was not gaining any immediate traction, he was authorised by Mr Kerr to offer this term as a "sweetner" to encourage Mr Grill to proceed. Mr Kerr was adamant that he had given no such instructions and in closing submissions Mr Stewart QC relied heavily on the fact that at 8.40 am the same day Torchlight's solicitor, Mr Michael Tinkler, circulated a draft Loan Agreement and General Security Deed[1] to Mr Kerr, which Mr Kerr in turn approved to be sent to Mr Skidmore, and which contained no reference to late payment fees. Torchlight submitted that this was inconsistent with any instruction on Mr Kerr's part to offer a penalty payment as at 7.08 am that day.

[26] I cannot accept Mr Kerr's evidence in this respect. Not only would it be quite extraordinary for Mr Skidmore to have proposed such substantial penalty payments

1 I will refer to this elsewhere in the judgment by the popular acronym "GSA".

without instruction, but it is inconsistent with an email sent from Mr Kerr to Mr Grill on 26 October 2012 (the date of the repayment), in terms:

> One issue that concerned me from a discussion with Andrew [Skidmore] last night was that we have always stated this was a fund launch and *requested* and received the right to pay a late payment fee to ensure flexibility on term date – albeit at $500k a week.
>
> (emphasis added)

[27] At 9.28 am on 17 August Mr Grill responded to Mr Skidmore in terms that he "continue[d] to be concerned about doing this deal" and advising that he was having a significant skin cancer operation that day. Mr Skidmore responded at 10.03 am in terms that he was "100% confident in the fact that you will exit this in 60 days time", that it would net Mr Grill AUD 1m over 60 days in an otherwise "benign market" and that, not only was the security cover four times the advance, but that it would "pave the way for a significant ultimate controlling stake in DHL in the short term". The email again referred to re-domiciling However, by 12.09 pm that day Mr Kerr had emailed Mr Skidmore with Torchlight's BOSI account details indicating that, at least by that stage, Mr Skidmore was probably aware of why the money was actually required.

[28] At this point there was something of a disconnection between the actions of Mr Kerr and the stage at which negotiations had reached between Mr Skidmore and Mr Grill. Mr Grill was still far from enthusiastic about the transaction but Mr Kerr's actions in providing BOSI account details ostensibly indicated preparations for imminent settlement. Mr Skidmore's evidence was that Torchlight was simply getting ahead of itself and that Mr Kerr could have had no realistic belief that a loan of this type and magnitude could be sourced and paid out within a matter of a few days. He emphasised that Mr Grill had not even met Mr Kerr at this stage nor had any due diligence been conducted. It is ultimately unnecessary for me to decide the reason for this mismatch in expectations. I accept an understandable desire on the part of Torchlight to get "ahead of the curve" as much as possible with regard to documenting the transaction, in order to minimise any delays in repayment of BOSI. The due date for that repayment had already arrived.

[29] In any event, Mr Skidmore did not provide the draft loan documents to Mr Grill. Mr Grill had not agreed to proceed on any terms at that stage, had already made it clear he would not be interested in a return of only AUD 1m and provision of draft documents would, in that context, Mr Skidmore said, have been counter-productive.

[30] On 17 August at 2.17 pm Mr Skidmore responded to Mr Kerr's provision of BOSI account details with an email in unusual terms stating:

> Confirming all is in order other than the final signature of JMG.
>
> Unfortunately JMG has gone into urgent surgery today. He will therefore not be in a position to authorise the transfer today.
>
> I anticipate that I will see him tonight or over the weekend and the transfer will proceed by COB Monday.
>
> Apologies for the delay.

[31] In evidence Mr Skidmore described this as a "Dorothy Dixer".[2] He says that he provided the email to Mr Kerr at his specific request so that Mr Kerr could placate BOSI, something which in hindsight he now regreted. That suggestion gains credibility from the fact that approximately an hour later Mr Kerr forwarded Mr Skidmore's email to Arnold Bloch Lieber, the solicitors acting for BOSI. Forty minutes later Mr Kerr also forwarded it to his personal contact in BOSI Mr Larry Mahaffy.

[32] At about the same time, Mr Grill approached Credit Suisse to see whether it would lend Wilaci the AUD 37m required. Mr Grill stated that, although it was far from clear to him at that stage whether the transaction would proceed, he wanted to make a precautionary application as there was no point in discussing matters further if the bank would not lend that sum. The result was a loan offer dated 20 August 2012 from Credit Suisse for a maximum amount of AUD 40m secured by a maximum number of 3,500,000 WorleyParsons shares (having a value of approximately AUD 90m at that time).

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[2] A reference to the American advice columnist Dorothy Dix who reputedly made up her own questions to allow her to publish more interesting answers.

[33] On Monday 20 August at 1 pm Mr Kerr and Mr Skidmore met with Mr Grill. Mr Grill described it as a high level meeting at which he made it clear he would only be interested in the transaction if it "made sense for Wilaci", that is, if the return reflected the risk. He stated that Mr Kerr was cool and apparently relaxed and made no mention of urgency or the need to repay BOSI. Although I accept that Mr Kerr would have sought to maintain a relaxed demeanour, my assessment is that by this stage the fact that a loan repayment formed some part of the elaborate structures he was proposing was, in fact, information communicated to Mr Grill. Only on that basis is the email referred to in my next paragraph explicable. However, having heard Mr Kerr give evidence I have no doubt that Mr Skidmore was correct in saying that there were "several strands to his business strategy underlying the need for $37m finance" and that Mr Kerr was anxious to place the repayment in a wider and positive context.

[34] At 3.51 pm the same day Mr Kerr provided Mr Skidmore with what he identified as a "proposal with teeth". This was an obvious response to Mr Grill's request that he be offered a deal which reflected the risk. The email was immediately forwarded by Mr Skidmore to Mr Grill. In it Mr Kerr proposed that, in exchange for the funding, he would procure the option of Mr Grill either:

(i) selling what was by then Wilaci's AUD 27m Pye DHL loan to PGC for cash; or

(ii) exchanging the loan for a cornerstone interest in PGC following privatisation.

The email identified the true purpose of the loan in terms:

> As you know the Torchlight RCL loan is a catalyst for this – and it is very important to me personally to close up.
>
> Hence all my cards are laid out in front of you.

[35] There followed a number of emails between Mr Skidmore and Mr Grill, Mr Kerr and Mr Grill, and Mr Kerr and Mr Skidmore relating to a possible PGC investment, culminating in an email from Mr Kerr to Mr Grill at 4.36 pm on Tuesday

21 August in which Mr Kerr proposed a privatisation of PGC, "indirectly financed by yourself" which he suggested would result in an uplift in value of $10m which he proposed be split between them, "so circa 5m each". He suggested that "The timing of the 5m will be parri passu in timing within 14 days closing of PGC privatisation".

[36] In his evidence Mr Grill stated that, although he explored this proposal further, he had "no real appetite for it". That does not sit comfortably with his email of 21 August 2012 to Mr Skidmore which suggests that he would "contemplate an arrangement" which, from the terms of the email, appeared to envisage an investment in PGC.

[37] On receipt of Mr Kerr's proposal, Mr Grill says that he "took it … that the return on the investment of $1m originally offered was now being proposed at $5m" and that it was "not clear to me from this email that Mr Kerr was proposing only an equity investment in PGC as Mr Kerr now contends". I consider it reasonably obvious that what was proposed at that stage was an equity investment and in his brief of evidence Mr Grill fairly conceded that "by this stage some level of confusion has (sic) arisen in relation to the whole question of PGC Investment".

[38] Mr Kerr's email was immediately followed by one from Mr Skidmore to Mr Grill (at 4.47 pm), in terms:

> John,
>
> This is as good as I can do.
>
> You now make $5m as opposed to $1m…

[39] 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.

[40] Mr Skidmore's evidence was that later on 21 August he phoned Mr Grill who said that he was only interested in a straightforward loan to Torchlight and neither wanted a shareholding in PGC nor any other complex arrangements. However, he did indicate that a fee of AUD 5m for a 60 day advance would be acceptable to him. Mr Skidmore then confirmed this by phone to Mr Kerr who agreed to proceed on that basis.

[41] Torchlight's solicitor Mr Naylor then prepared loan and general security agreements which were executed by Torchlight and forwarded to Mr Grill at 10.50 am on 22 August. Schedule 1 to the Loan Agreement provided for an advance date of 22 August, a term of 60 days, a fixed interest rate of 5.25 per cent, a default rate of 5 per cent "above the then current interest rate" and a fee of AUD 5 million payable 120 days following the date of the advance. The fixed rate interest for the period of the advance, calculated in the amount of AUD 320,000, was payable on the Date of Final Payment being 60 days after the Date of Advance.

[42] At 11.57 Mr Grill emailed his solicitor Mr Shihadie, Mr Skidmore and Mr Kerr saying that he would be engaging the services of Mr Kurt Jeston to undertake due diligence on the transaction. This was not a welcome development from Mr Kerr's perspective in that it meant inevitable further delay in circumstances where Torchlight was incurring substantial penalty interest to BOSI. It cannot, however, have been unexpected.

[43] Mr Skidmore endeavoured to accelerate the process by emailing Mr Grill and stating that he had "inadvertently set an expectation in the mind of George Kerr that due diligence on the deal would be completed today given that the structure is now relatively straight forward". He also sent a further email to Mr Kerr, again in what he described as Dorothy Dixer terms, for the purposes of placating BOSI. Given that Mr Grill had only just appointed Mr Jeston to conduct due diligence, the email gave an impression of a transaction significantly more advanced than was actually the case.

[44] Mr Skidmore's email to Mr Kerr at 6.22 pm on 22 August is revealing in terms of how the transaction was at that stage tracking. It notes a discussion that Mr

Skidmore had just had with Mr Grill and that Mr Grill felt he was being pushed into the transaction, that in Mr Grill's words "no-one in the world would expect AUD 37m without proper due diligence" and that he would not be "rushed for someone else's timetable". The email stated:

> He [Mr Grill] simply was not a buyer of an increased fee for the advance being expedited. Rather, his (rather strident) view is that it was not until last night that he was presented an equitable arrangement that was palatable".

[45] Shortly afterwards, a detailed email arrived from Mr Jeston setting out 15 due diligence inquiries. Mr Skidmore's evidence was that this provoked a somewhat explosive reaction from Mr Kerr (at whose offices he was working when the email arrived) and that there was initially talk of approaching other lenders. However, Mr Kerr later confirmed to Mr Skidmore that Wilaci remained his preferred lender and immediate efforts were then made to satisfy the due diligence inquiries.

[46] At 7.25 am on 23 August 2012 Mr Skidmore reported to Mr Grill that "all expectations are now in check".

[47] Mr Grill, who had been out of Sydney, returned on the evening of Thursday 23 August. Mr Jeston reported the following day stating that he had been working through the assets and getting comfortable that they provided sufficient collateral and that he was also comfortable with cash flows from the RCL debt (which had been identified as one of the sources of repayment in Mr Kerr's email to Mr Grill of 21 August at 4.36 pm). Mr Jeston then inquired whether Mr Grill was "expecting a 5.25% interest rate plus $5m fee plus a cost recovery which includes the Credit Suisse loan costs?"

[48] Mr Grill's response[3] is significant in that it raised again the subject of the "penalty" Mr Skidmore had proposed in his email the previous Friday. The response was in terms:

> I am expecting to recover all my costs of going into the transaction which include legal, financial advice etc, loan set up costs (if any), interest cost on

[3] Mr Jeston's email is noted as having been sent at 1.47 pm and Mr Grill's response at 11.56 am. The discrepancy is unexplained but presumably relates to the time settings on one or other computer. The parties agreed that Mr Grill's email of 11.56 am was a response to Mr Jeston's "feedback request".

> the $37m (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.

[49] Mr Grill's requirements in relation to the late payment sum were communicated to Mr Kerr and Mr Skidmore says he was told to try to negotiate the figure down. At 6.50 pm on Friday 24 August Mr Skidmore emailed Mr Grill proposing that what he termed the "$1m per week penalty interest" be reduced to AUD 100,000 per week. The email contains a reference to the "aim" of the payment being to "incentivise settlement" and to the suggested AUD 100,000 per week being "a very significant incentive when viewed in the overall context of the total coupon payment for the 60 day period is (sic) $5m".

[50] Mr Skidmore's proposals had an element of optimism given the earlier offer by him at the level of AUD 1m per month.[4] However, undeterred, he sent an email 10 minutes later describing AUD 100,000 per week as being "more than double the penalty of 500 bps over the bank bill rate that is currently proposed in the Loan Agreement" and, although "totally justified", also "fair and reasonable".

[51] Mr Grill responded at 12.55 pm on Saturday 25 August in terms which featured prominently in Torchlight's case. He stated:

> I didn't ever agree to the 500 bps over the bill rate in the loan agreement. It has never been discussed.
>
> 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 have suggested $1 million. A compromise of say $500k would be okay to me.

[52] Mr Skidmore forwarded that email to Mr Kerr's financial advisor, Mr Naylor, who responded to Mr Kerr in terms:

> Starting to get ridiculous.
>
> Do we have any viable alternative or are we a price-taker?

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

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4 Albeit in the context of much lower facility fee.

Mr Skidmore was accordingly instructed to accept Mr Grill's "compromise" which he did by email timed 1.32 pm and in terms:

> Thought you would say that!
>
> Done.
>
> Russell,
>
> Please have Michael Tinkler adjust the loan agreement to reflect this and send to Michael Shehadie.
>
> George, [Kerr]
>
> A bottle of wine to Rush St, Woollahra!

[54] The revised transaction documents were duly prepared and executed by the parties on Monday 27 August 2012, although dated 22 August 2012. Arrangements were simultaneously made for transfer of the AUD 37m from Credit Suisse to BOSI. At the same time Torchlight executed the GSA.

The Loan Agreement

[55] This defined the loan terms as those set out in Schedule 1. They are repeated in full below.

Schedule 1: Loan Terms

(i)	Loan:	AUD$37,000,000
(ii)	Date of Advance:	The 22nd day of August 2012
(iii)	Term:	60 days
(iv)	(a) Interest Rate: (per cent per annum)	The Credit Suisse cost of funds plus a margin of 150 basis points on a pass through basis from the Lender to the Borrower
	(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

(v) Borrower's Payments:

(a) Fee	AUD$5,000,000 payable 120 days following the Date of Advance.
(b) Payment of Interest	An amount of $320,000 being the interest payable on the Loan during the term of the Loan shall be paid on the Date of Final Payment (being 60 days following the Date of Advance)
(c) Term Payments	No payments during the term one final payment on the Date of Final Payment of principal, interest and fees (to the extent no paid).
(d) Number of Term Payments	Nil.
(e) Date of Final Payment	60 days after the Date of Advance

(vi) Securities:

General Security Deed over all of the assets and undertaking of the Borrower.

(vii) Credit Contracts Act:

All the terms of the Credit Contract are obtained in this Agreement and the Securities. The following information is required to be disclosed by the Credit Contracts Act 1981.

(a) Cost of Credit:

Establishment Fee	$ 5,000,000
Interest	$ 320,000
Other Costs (excluding interest)	Nil
Total Cost of Credit	$ 5,320,000

(b) Amount of Credit:

The Loan	$37,000,000
Establishment Fee	$ 5,000,000
Other Costs (excluding interest)	Nil
Amount of Credit	$42,320,000

(ix)(Sic) Loan Disbursement:

The Borrower requests that the Loan be disbursed the Borrower's bank account with the National Australia Bank, being such account number as advised by the Borrower to the Lender.

(x) Fixed Interest Rate:

The Borrower will pay interest on the loan at the ordinary rate of 5.25% per annum fixed (and non-reviewable) to the "Date of Final Payment" entered above (the fixed rate period).

[56] Clause 3 of the Agreement in turn provided:

3.1 The Borrower shall repay the Loan together with the Borrowers Payments as detailed in the clause v of Schedule 1 on the Dates set out in Schedule 1.

3.2 Interest accrues daily but is payable in arrears on each Payment Date.

3.3 Any moneys payable to the Lender shall be paid, without any set-off or deduction whatsoever, not later than 1.00 pm on the due date by direct debit authority to the account of the Lender advised to the Borrower.

3.4 If any due date is not a Business Day, payment shall be made on the next Business Day unless that next Business Day occurs in the following month, in which event the payment shall be made on the previous Business Day.

3.5 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.

3.6 If any payment is made after 4.00 pm on the due date the Borrower shall pay to the Lender, immediately upon request, interest on the payment concerned at the Default Rate until the next Business Day as if the payment were made on the later day.

3.7 If the Loan is not advanced on the Availability Date, the Borrower shall pay to the Lender on the Date of Advance (or the date the Facility is cancelled, as the case may be) a commitment fee for the period from the Availability Date until that day. The fee will accrue daily and will be charged at a rate per annum certified by the Lender to be qual to the Interest Rate less the rate then paid by the Lender for call deposits of amounts similar to the Loan. The minimum rate to apply under this sub-clause shall be five per cent per annum.

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

3.9 The Borrower may prepay the Loan as set out in paragraph (vii) in Schedule 1.

[57] Clause 6 dealt with events of default. Relevantly it provided:

6.1 If at any time and any reason, whether or not within the control of the party:

(a) The Borrower fails to pay on its due date:

(i) Any amount payable under any Relevant Document; or

(ii) Any amount payable by the Borrower to the Lender on any account whatsoever;

then this Agreement, the Securities and the other Relevant Documents shall become immediately enforceable and the Lender may, at any time, by notice to the Borrower:

(s) Cancel the Facility; and

(t) Declare all or any part of the Loan and any other indebtedness of the Borrower under the Relevant Documents to be, and that indebtedness will be, due and payable either immediately or upon demand or at a later date as the Lender may specify.

Subsequent events

[58] The loan was due to be repaid by 26 October 2012. It was not. That in my view was a clear event of default under the Loan Agreement making the indebtedness repayable upon demand. Furthermore, under the GSA Torchlight became exposed to the onerous enforcement rights granted to Wilaci. Clauses 12 and 13 included the right to take possession of and sell Torchlight's property, to take control of and manage Torchlight's business and to place Torchlight into receivership. Significantly also, the "Late Payment fee" began to accrue.

[59] The defendant did not immediately make demand. Rather it sought to manage repayment, which it eventually achieved by seven tranches, the first on 1 October 2013 and the last on 2 May 2014. That period is one Mr Skidmore describes as characterised by "endless excuses and broken promises" from Mr Kerr and by various settlement agreements which were not performed.

[60] Wilaci places significant emphasis on the many communications from Mr Kerr in the period October to December 2012 which indicate his belief that the Loan Agreement provided for the right to extend repayment beyond the due date, albeit on payment of the Late Payment fee. Characteristic of those communications is the email of 26 October 2012 referred to in [26].

[61] The rationale for this approach was obvious. Neither from RCL cash flows, capital raising nor alternative borrowings had Torchlight been able to secure funds with which to make the repayment. It was buying for time and Mr Kerr's consistent

refrain was that the facility provided Torchlight with an "equity bridge" in the context of new capital raising, whenever completed. In an email sent by Mr Kerr to Mr Skidmore on 15 December 2012 (in turn intended to be forwarded to Mr Grill), Mr Kerr went so far as to identify equity as the largest cost to most businesses and the fact that:

> If we are prematurely forced to close [the equity raising programme] before we are legally entitled to under the equity bridge the cost of that is theoretically and practically A LOT MORE THAN 5M AND 500K A WEEK – eg a needless 10% dilution is $30m to $60m".

[62] To similar effect was his observation on 22 December that Wilaci's financing was "cheap for equity bridge expensive for debt bridge". I will return to consideration of this correspondence in my discussion of the defendants' first argument, namely that the law of penalties is not engaged because what was contemplated by the Late Payment fee was a sum payable for an additional service, namely extension beyond due date.

Receivership

[63] On 29 May 2013 Wilaci served a demand on Torchlight in the amount of AUD 33,628,934, comprising:

1. The AUD 5m fee;

2. Accrued Late Payment fees;

3. Term interest of AUD 320,000.

[64] The demand went unsatisfied and on 10 June Wilaci appointed the first defendants as receivers.

[65] On 4 November 2014 Wilaci served a statutory demand in response to which Torchlight paid the AUD 320,000 term interest and AUD 1m on account of the initial AUD 5m fee, with further funds placed on deposit with its New Zealand solicitors to cover the balance of that fee and accrued interest. Shortly before trial, Torchlight conceded its position in respect of the balance of the facility fee and now accepts that

sum, together with accrued interest on it, as payable. At the commencement of trial I was advised that the plaintiff had now directed its solicitors to make immediate payment of such sums. I nevertheless intend to give judgment for them having not, at the date of publication of this judgment, received confirmation of the payment from Wilaci.

The law

Introduction

[66] Clause 12.7(a) provides that the Loan Agreement is governed by the laws of New South Wales. Both Torchlight and Wilaci called expert evidence in terms of the applicable law.

[67] For Torchlight, evidence was given by Dr Kevin Lindgren AM QC, a retired Judge of the Federal Court of Australia, and Elisabeth Peden, a former Professor of the University of Sydney law faculty who has, since 2008, practised as a full-time barrister in Sydney. Wilaci's legal expert was Mr Francis Douglas QC, a senior silk based in Sydney.

[68] Dr Peden gave evidence in person and was cross-examined. The affidavit evidence of Dr Lindgren and Mr Douglas (including a second affidavit filed by Mr Douglas in response to certain matters raised with Dr Peden in supplementary oral evidence) were received without cross-examination. I was invited by the parties to consider any of the authorities referred to by the various experts in the assessment of their evidence. These were collected in what were ultimately five bundles. I have accepted that invitation in relation to a number of authorities.

[69] There are substantial areas of agreement between the experts but some important differences of emphasis and detail.

Applicable rules of precedent

[70] I start by summarising the principles of the precedent applicable under Australian law had this matter been decided by a Judge of the Supreme Court of NSW.

[71] These principles are summarised in Mr Douglas' second brief of evidence and are not disputed by the plaintiff.

[72] Mr Douglas deposes that the question of precedent in Australia is governed by the hierarchical nature of Australia's court system. He states:

> Judgments pronounced in the federal sphere, other than in [the] High Court, which is the ultimate appellate court from both federal courts established under Chapter III of the Constitution and the States' Supreme Courts, are persuasive only in the State Courts. Judgments of the Courts of Appeal of the States or Territories are binding on first instance judges in the State or Territory concerned in accordance with the principles of *stare decisis*, and persuasive authority in other States and Territories and in Federal Courts. Otherwise judgments at first instance are persuasive

[73] He goes on, however, to cite the recent decisions of *Farah Constructions Pty Ltd v Say-Dee Pty Ltd*[5] and *Duckworth v Water Corporation*,[6] the latter being what he describes as "the last word on the subject", in support of the view that equivalent trial judges in the respective Supreme Courts of the various Australian States should follow each other unless satisfied that the earlier decision was "plainly wrong".

[74] The specific question put to Mr Douglas and referred to in his second brief of evidence related to the precedent value before the NSW Supreme Court of a Queensland Supreme Court decision. That arose out of Mr Douglas' reliance on the decision in *PT Thiess Contractors Indonesia v PT Arutmin Indonesia*,[7] which Dr Peden described in her supplementary evidence as "a first instance decision of the Queensland Court and it will not be binding in NSW".

[75] Mr Douglas' evidence in that respect, following on from his discussion of the cases previously referred to, was that:

> This would mean that it would only be open for a Justice of a Supreme Court of New South Wales to depart from a decision of a Justice of the Supreme Court of Queensland if he or she were persuaded that authority was plainly wrong. In any event, if the reasoning of the Justice of the Supreme Court of Queensland was based on a decision or decisions of an intermediate appellate court or courts, including the Full Court of the Federal Court, they would be obliged to follow the reasoning of that intermediate appellate

5 *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22, (2007) 230 CLR 89 at [135].
6 *Duckworth v Water Corporation* (2012) 261 FLR 185 (WASC) at [31].
7 *PT Thiess Contractors Indonesia v PT Arutmin Indonesia* [2015] QSC 123.

> court, unless it was plainly wrong. Obviously all subordinate courts, whether State or federal are bound in accordance with the principles of *stare decisis* by the High Court of Australia.

Issues

[76] The parties and their experts agree that two discrete legal issues emerge from the proceedings, namely:

1. Whether the penalty doctrine is engaged at all; and

2. If it is engaged, whether the Late Payment fee is properly characterised as penal or as a genuine pre-estimate of damage in the relevant sense.

The first issue

[77] The first issue is one of construction of the contract and involves an assessment of whether the Late Payment fee is, on the one hand, a sum payable for an additional benefit or, on the other, is a sum payable upon breach or as a secondary collateral or accessory stipulation for a primary stipulation. The position is summarised by Allsop CJ in *Paciocco v ANZ Banking Group Ltd* where he says:[8]

> Sometimes, the proper conclusion may not be that the sum is a genuine pre-estimate of loss, but that the sum is payable for an additional benefit, a conclusion made by reference to the antecedent inquiry whether it is a collateral or accessory clause at all, or whether it is part of the bargain for another right… If it is so regarded, it necessarily takes its character as something different in nature from a clause which in terms or in its origins of contractual creation was intended by the parties as agreed damages.

[78] That principle had previously been endorsed by the High Court of Australia in *Andrews v ANZ Banking Group Ltd* where the Court stated:[9]

> The operative distinction would be that upon which the majority of the New South Wales Court of Appeal (Jacobs J and Holmes JJA) decided *Metro-Goldwyn-Mayer*. Their Honours contrasted a stipulation attracting the penalty doctrine and one giving rise consensually to an additional obligation.

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8 *Paciocco v ANZ Banking Group Ltd* [2015] FCAFC 50 at [100].

9 *Andrews v ANZ Banking Group Ltd* [2012] HCA 30, (2012) 247 CLR 205 at [80].

[79] In terms of the law relating to the construction of contracts, Mr Douglas describes this in his second brief of evidence as having been a "very vexed area" in Australia since the decision in *Codelfa Construction Pty Ltd v State Rail Authority (NSW)*.[10] Since neither of the parties adduced expert evidence in this respect I was invited by agreement to apply the relevant principles of New Zealand law, particularly those set out in *Vector Gas Ltd v Bay of Plenty Energy Ltd*.[11]

[80] During argument this issue came to be referred to as the "MGM issue" on account of the leading authority previously referred to.[12] I will do likewise.

The second issue

[81] Assuming I was to find that the collateral or accessory stipulation was in the nature of security for the satisfaction of the primary obligation and that the law of penalties was therefore engaged, each of the experts set out in detail, by reference to recent relevant authority, the principles which I would be obliged to apply under NSW law.

[82] Those principles are far from alien to a New Zealand lawyer or judge given the extent to which English common law and equitable principles have infused the jurisprudence of both jurisdictions.

[83] As Dr Peden explained in her evidence, the jurisdictional basis for the Court's involvement is that penalty clauses purport to oust its jurisdiction to determine the appropriate damages on breach of contract. The plaintiff in a breach of contract claim is only entitled to contractual damages as assessed by the Court unless the parties have themselves provided for a genuine pre-estimate of loss as a proxy for the Court's assessment.

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10 *Codelfa Construction Pty Ltd v State Rail Authority (NSW)* [1982] 149 CLR 337.
11 *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5.
12 *Metro-Goldwyn-Mayer Pty Ltd v Greenham* [1966] 2 NSWLR 717 (NSWCA).

Dunlop

[84] Each of the experts take as their starting point on the second issue the formulation by Lord Dunedin in *Dunlop Pneumatic Tyre Company Ltd v New Garage and Motor Company Ltd*[13] — one applied by the High Court of Australia in *Ringrow Pty Ltd v BP Australia Pty Ltd*[14] and described by the High Court in *Andrews* as being a product of centuries of equity jurisprudence.[15]

[85] The relevant passage from Lord Dunedin's judgment in *Dunlop* is well known but usefully repeated.[16]

> 1. Though the parties to a contract who use the words "penalty" or "liquidated damages" may prima facie be supposed to mean what they say, yet the expression used is not conclusive. The court must find out whether the payment stipulated is in truth a penalty or liquidated damages. This doctrine may be said to be found passim in nearly every case.
>
> 2. The essence of a penalty is a payment of money stipulated as in terrorem of the offending party; the essence of liquidated damages is a genuine convenanted pre-estimate of damage…
>
> 3. The question whether a sum stipulated is penalty or liquidated damages is a question of construction to be decided upon the terms and inherent circumstances of each particular contract, judged of as at the time of the making of the contract, not as at the time of the breach…
>
> 4. To assist this task of construction various tests have been suggested, which if applicable to the case under consideration may prove helpful, or even conclusive. Such are:
>
> (a) it will be held to be 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. Whether it had its historical origin in the doctrine of the common law that when A. promised to B. a

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13 *Dunlop Pneumatic Tyre Company Ltd v New Garage and Motor Company Ltd* [1915] AC 79 at 86-87.

14 *Ringrow Pty Ltd v BP Australia Pty Ltd* [2005] HCA 71; (2005) 224 CLR 656 at 662-663.

15 *Andrews v ANZ Banking Group Ltd* above n 9, at [15].

16 *Dunlop Pneumatic Tyre Company Ltd v New Garage and Motor Company Ltd* above n 13, at 86-88.

> sum of money on a certain day and did not do so, B. could only recover the sum with, in certain cases, interest, but could never recover further damages for non-timeous payment, or whether it was a survival of the time when equity reformed unconscionable bargains merely because they were unconscionable, … is probably more interesting than material.
>
> (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….
>
> (citations omitted)

Paciocco

[86] All experts agreed that the very recent decision of the Full Court of the Federal Court of Australia in *Paciocco v ANZ Banking Group Ltd* was among the most significant in terms of the issues raised in the proceedings. Both that case and the earlier High Court decision in *Andrews* concerned class action litigation against ANZ Banking Group in relation to various categories of late payment and default fees.

[87] In *Andrews* the High Court decided that equity's jurisdiction to grant relief in respect of penalties had not been absorbed into the common law doctrine and that, unlike the common law, the equitable jurisdiction extended beyond cases of breach of contract.

[88] The question of whether the various categories of ANZ fees did in fact constitute penalties fell to be decided by Gordon J in *Paciocco* in the Federal Court.[17] Her Honour concluded that the Late Payment fee constituted a penalty but that the other fees did not. ANZ appealed in respect of the former finding, and Mr

[17] *Paciocco v ANZ Banking Group Ltd* [2014] FCA 35.

Paciocco and his company in respect of the latter, to the Full Court of the Federal Court of Australia. The appeal by ANZ was successful but the appeal by Mr Paciocco and his company failed. The principal judgment is that of Allsop CJ which I refer to in some detail below.

[89] The Chief Justice's analysis of the principles commences with his discussion, at [19] – [28] of the decision under appeal. Although Gordon J had recognised that the circumstances that enliven the penalty doctrine at common law and in equity are different (breach of contract at law and failure of a collateral or accessory stipulation in Equity) she held that, common to both was the fact that a provision would not be a penalty unless it was "extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved", thus adopting Lord Dunedin's test.

[90] Allsop CJ then in part paraphrased and in part elaborated on her Honour's reasoning by stating:[18]

> The requirement for extravagance and unconscionability and its distinction from a genuine pre-estimate of damage must require the latter concept to be a broad objective one, not limited to a clause expressly said to be a genuine pre-estimate of damage or containing a sum actually fixed in amount by reference to contemporaneous considerations concerned with such. Rather if extravagance and unconscionability on the one hand and a genuine pre-estimate on the other, are to operate as the relevant universe of discourse, the latter must be a descriptive phrase used to explain a sum paid upon breach of a term or pursuant to a collateral stipulation upon the failure of the primary stipulation that is not extravagant and not out of all proportion to the compensation for the breach or failure of the stipulation. The penal character of a provision is derived from the extravagance of the relationship between the payment and the possible loss capable of compensation. If there is no extravagance present the provision failure of which admits of compensation is taken to be a genuine pre-estimate of damage, and not penal in character.

[91] At [95] – [187] of the judgment his Honour expanded on this analysis. I identify below the principal points I distill from his discussion:

1. The assessment of whether a clause in question is penal in character is one of construction in the wide sense falling to be decided by the

[18] *Paciocco v ANZ Banking Group Ltd,* above n 8 at [25].

meaning and content of the words and on the inherent circumstances of each particular contract judged at the time of its making.[19]

2. This process involves the related tasks of ascribing meaning and content to the relevant clause (by the usual processes of construction and interpretation) and also the necessary characterisation of the clause (as interpreted) in its full context.[20]

3. The essential feature of a penalty is that it constitutes a secondary stipulation, collateral or accessory to a primary stipulation and which is in the nature of security for and *in terrorem* of, the satisfaction of the primary stipulation.[21]

4. The secondary stipulation must impose an additional detriment that is out of all proportion to the loss suffered by the obligee on the failure of the primary stipulation or that is inordinate or extravagant or oppressive.[22]

5. Although the adjectival descriptions of the relevant disproportion vary in the cases, “extravagant”, “exorbitant”, “oppressive”, “inordinate” and “unconscionable” can be seen as broad synonyms.[23]

6. The secondary stipulation will be penal if it is not a genuine pre-estimate of loss. The Chief Justice noted that the dichotomy of penalty and genuine pre-estimate is central to the operation of the penalty doctrine and has its roots in the distinction between compensation and security.[24] However, absent extravagance in the sense referred to, a provision will not be considered penal even if the parties did not express the clause to be an agreed pre-estimate of

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19 At [95].
20 At [95].
21 At [95].
22 At [95].
23 At [95].
24 At [96] – [98].

damage and even if the parties did not negotiate or set the amount payable by reference to an estimate of damage.[25]

At [140] the point is summarised in these terms:

> As I have already discussed, the notion of a genuine pre-estimate of damages is not a description of the contractual or pre-contractual activity of the parties. Rather it is the objective reflex of a penalty: a payment on breach or failure of a collateral stipulation that is not proved to be extravagant or exorbitant.

7. Significantly, Allsop CJ then turned to what he called "the legitimate scope of the compensation that is the subject of the assessment of extravagance or exorbitance.[26] He considered it essential to distinguish the object and purpose of the doctrine of penalties (the prevention or limitation of oppressive or unconscionable terms) and the means of prevention or limitation (the leaving of the obligee to an action in damages). In respect of the former, the following statement was given prominence in Wilaci's submissions:[27]

> The object and purpose of the doctrine of penalties is vindicated if one considers whether the agreed sum is commensurate with the interest protected by the bargain: *Andrews* (HC) at [75]; *Dunlop* at 91-93; *Clydebank* at 15 – 17, 19 and 20; *Public Works Commission v Hills* at 375 – 376. This is not to say that the inquiry is unconnected with recoverable damages; but the question of extravagance and unconscionability by reference, as Lord Dunedin said in *Dunlop*, to the greatest loss that could conceivably be proved to have followed from the breach, is to be understood as reflecting the obligee's interest in the due performance of the obligation.[28]

8. At [95] and [183] Allsop CJ emphasised the *ex ante* nature of the inquiry, with the result that analysis in terms of exorbitance or extravagance is to be taken to be part of the assessment of whether the fee *is* a penalty, not of assessing the consequences of it being a

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25 At [99]-[101]. See also [25].

26 At [103].

27 At [103].

28 At [103].

penalty. It was in this respect, primarily, that the Court considered the trial judge to have erred (by adoption of an *ex post* damages analysis).

9. At [184] – [187] His Honour concluded that the appellant customers had not discharged their onus of proof. He stated:[29]

> In any given case, what might be critical or decisive in the examination of all the circumstances might be (as here) the analysis of the extent of legitimate protection of the obligee's interest measured in the manner discussed in *Dunlop*, or … the clear contractual purpose of the coercion of performance by the payment or forfeiture of a large amount of money. One must examine all the circumstances. Here given the nature of the relationship, the legitimate interest of ANZ and the correct analytical perspective, the fees were not demonstrated to be extravagant, exorbitant or unconscionable.

Yarra

[92] The principal authority relied on by Wilaci is *Yarra Capital Group Pty Ltd v Sklash Pty Ltd*.[30] Mr Douglas went so far as to suggest the facts were "very analogous". The first appellant and respondent were money lenders making short term loans in what were described as "circumstances of significant risk and, effectively, at unusually higher rates of interest".[31] Characteristic of the loans in question was one for $100,000 for a two month period with a "once only" fee of $20,000. For each day that the loan or any part of it was outstanding beyond due date the first appellant was required to pay the respondent $328.50. It was alleged that this default rate constituted a penalty and was therefore unenforceable. That allegation was rejected by the Master, likewise on appeal to a judge of the Supreme Court of Victoria and on further appeal by a majority in the Court of Appeal.

[93] The majority's conclusion appears from [17] – [18] in terms:

> [17] In the present case it is self-evident that the market in which the respondent operated was materially different from one in which banks and like institutions lend money. In the latter case there would probably be acceptable industry benchmarks as to the cost of money and the prevailing interest rates against which one could establish,

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29 At [187].

30 *Yarra Capital Group Pty Ltd v Sklash Pty Ltd* [2006] VSCA 109 at [15].

31 At [3].

> with relative ease and accuracy, the loss to the lender arising from its inability to use its money caused by the borrower's default in repayment. But the respondent operated in a completely different market. It was, as I have said, a short term money market where the loans, effectively, were unsecured and where the cost of borrowing was, on any view, unusually high, if not exorbitant. In those circumstances, it would be a complex and expensive exercise to seek to establish, with any sort of precision, what damage is likely to flow from a failure by the appellants to repay the principal on the due date. Thus, the default amount that has been struck by agreement of both parties probably obviated a "minute and somewhat complex system of examination which would arise if you were to attempt to prove the damage".[32] In those circumstances, as I have indicated, the courts are even more reluctant to grant relief on the basis that the agreed damages clause is a penalty.
>
> [18] Given the terms of these particular agreements and their intended operation, as I have described, I am not persuaded that it is reasonably arguable that the default clause is so out of proportion with the loss that it is likely to flow from the appellants' breach that it can be properly characterised as being oppressive.

[94] Importantly however, the majority had earlier concluded that, absent default, the respondent's expected earnings averaged out, broadly at about $175 per day, based on the "up front fee" and that "there is nothing in the material which suggests that this did not reflect, in general terms, the minimum loss that the respondent was likely to suffer by reason of the appellants' breach of contract".[33] So in that sense the "up front fee" was treated as a proxy for likely loss and, as Mr Hunter submitted, the default rate (approximately twice) was not considered extravagant or unconscionable by comparison. It was as the judge under appeal had stated, broadly "in the same ball park". Mr Hunter submitted, that had Wilaci regularly lent out substantial sums for substantial up front fees then the analogy with *Yarra* would be valid. However, he emphasised that this was not Wilaci's evidence, that Wilaci was not in the business of being a money lender and that it had never in fact "initiated any lending proposals to borrowers (other than to … family members)". To that end, he submitted the fact that the AUD 500,000 per week represented an annualised return approximately 10 per cent less than that reflected in the up front fee of AUD 5m did not, as Mr Gedye contended, make this a stronger case to uphold the payment than *Yarra*. Rather, in Mr Hunter's submission, this was a case where the up front fee was

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32 *Clydebank Engineering and Shipbuilding Company Ltd v Don Jose Ramos Yzquierdo Y Castaneda* [1904] UKHL 3, [1905] AC 6 at 11 per Halsbury LJ.

33 *Yarra Capital Group Pty Ltd v Sklash Pty Ltd*, above n 30, at [15].

not an appropriate proxy at all for likely loss and where the default stipulation in fact provided for a payment many times such loss.

[95] I consider care is necessary in comparison of this case with *Yarra* given the very different natures of the lenders' business in each case. Its discussion of the relevant principles is, however, one which, like the experts, I found useful.

Greatest loss conceivably proved or greatest loss likely?

[96] The test stated by Allsop CJ at [103] and repeated at [137] references the exact words of *Dunlop* in terms that the obligee's legitimate interest in the performance of the contract is to be assessed by reference to "the greatest loss that could *conceivably be proved* to have followed from the breach".[34] In her brief of evidence, Dr Peden invoked the language of loss "likely to flow from the breach that protects the relevant interest of the lender", although later stating:

> If the specified sum of the payment obligation in a contract is "out of all proportion" or "extravagant and unconscionable" in comparison with the greatest loss that could have flowed from the breach to protect the relevant interest then the clause will be a penalty".

[97] The difference between "greatest loss" and "loss likely to flow from the breach" was addressed in Dr Peden's supplementary oral evidence. Her position was that, in at least four Australian High Court cases of which she was aware and numerous intermediate appellate decisions, the expression "greatest loss" as used in *Dunlop* had been interpreted in the language of loss likely to flow from the breach. She considered there was not, in fact, any real difference between the respective formulations because where Lord Dunedin referred to the "greatest loss …. proved" "you are looking at foreseeable damage, and so foreseeable damage is likely loss".

[98] I note that although Mr Douglas responded to other aspects of Dr Peden's supplementary evidence by way of a second brief, no challenge was made to her reference to likely loss as the test appropriately applied. I infer therefore his acceptance of that proposition.

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[34] *Paciocco v ANZ Banking Group Ltd*, above n 8, at [137]. See also [101] where his Honour uses the phrase "likely loss".

[99] The leading High Court of Australia decision in this respect is that of *Ringrow Pty Ltd v BP Australia Pty Ltd* where a unanimous six judge panel said:[35]

> The law of penalties, in its standard application, is attracted where a contract stipulates that on breach the contract breaker will pay an agreed sum which exceeds what can be regarded as a genuine pre-estimate of the damage likely to be caused by the breach.

[100] This was also the formulation adopted by Mason and Wilson JJ in *AMEV-UDC Finance Ltd v Austin*.[36]

[101] In terms of whether the clause fails for what Cole J referred to in *Multiplex Constructions Pty Ltd v Abgarus Pty Ltd* as a "lack of compensatory character",[37] I intend, therefore (consistent with the principles of precedent referred to earlier in this judgment), to approach the question of extravagance or exorbitance by reference to Wilaci's legitimate interest in performance of the contract assessed by reference to the damage *likely to be caused* by Torchlight's breach. In stating the test that way, I accept Dr Peden's proposition that there is in fact unlikely to be any material difference between the test as articulated by the High Court of Australia and as appearing in *Dunlop* by reason of Lord Dunedin's reference to greatest loss conceivably *proved*. I note a similar approach by the English Court of Appeal in *Makdessi v Cavendish Square Holdings BV*[38] where Clarke LJ described the question of whether the estimate contemplated is an estimate of the loss "which the innocent party will *probably* suffer or which he *might* suffer" as "something of a barren controversy"[39] and said:[40]

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35 *Ringrow Pty Ltd v BP Australia Pty Ltd*, above n 14, at [10].
36 *AMEV-UDC Finance Ltd v Austin* [1986] HCA 63, (1986) 162 CLR 170 at 181. See also *Yarra Capital Group Pty Ltd v Sklas Pty Ltd*, above n 30, at [12] where the Court referred in the context of *Dunlop* to "the disproportion between the agreed sum and the likely loss".
37 *Multiplex Constructions Pty Ltd v Abgarus Pty Ltd* (1992) 33 NSWLR 504 at 511 and 513.
38 *Makdessi v Cavendish Square Holdings BV* [2013] EWCA Civ 1539.
39 At [76] and [81].
40 At [81].

> Insofar as the court has to decide whether the sum provided for is a genuine pre-estimate of loss the question, prima facie, is whether it is a reasonable estimate of the likely recoverable loss of the innocent party.[41]

The role of oppression within the doctrine

[102] In its submissions Wilaci places significant emphasis on the following extract from the decision of Dickson J in the Canadian Supreme Court case of *Elsley v J G Collins Insurance Agency*:[42]

> It is now evident that the power to strike down a penalty clause is a blatant interference with freedom of contract and is designed for the sole purpose of providing relief against oppression for the party having to pay the stipulated sum. It has no place where there is no oppression.

[103] In his brief of evidence Mr Douglas stated that he considered the passage consistent with Australian law and likely to be persuasive authority in a NSW Court.

[104] I agree with Torchlight however that, at least within the context of Lord Dunedin's example 4(a), oppression in what Mr Hunter calls a "consumer protection sense" need not be established. The oppression is that in consequence of the disproportionality of the collateral stipulation to the loss likely to be caused by the breach. In *Multiplex* Cole J referred, in this context, to a clause, "which may be oppressive in consequence of its monetary impositions indicating that it is not of a compensatory nature".[43]

[105] However, under NSW law a clause may also fail as having been penally imposed in circumstances rendering enforcement of the clause unconscionable. That appears from the decision of Cole J in *Multiplex*.[44] Likewise in *Yarra* Chernov JA expressed the view, without being required to decide the issue, that, in Australia, unconscionability is a separate ground for striking down an agreed default provision

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41 The judgment goes on to acknowledge however, situations where, although the stipulated amount may significantly exceed the sum recoverable at common law, it will, nevertheless, not be considered a penalty because there is a "commercial justification" for its imposition. See [92] – [104] and [124] – [125]. This is referred to as the "new approach". None of the experts in the present case discuss this line of authority in detail. However, in my view what is contemplated by the "new approach" does not differ materially in result from Allsop CJ's focus on the extent to which the clause legitimately protects the obligee's interest in performance of the obligation.

42 *Elsley v J G Collins Insurance Agency* [1978] 2 SCR 916 at 937.

43 *Multiplex Constructions v Abgarus Pty Ltd*, above n 37, at 511 which I think captures the concept accurately.

44 At 511 and 513.

as a penalty.[45] In the present case, Torchlight's attack is based exclusively on disproportionality principles.[46] However, it emphasises that those principles apply irrespective of the fact that both Torchlight and Wilaci were sophisticated commercial parties headed by experienced businessmen. It relies on the following observation in *Makdessi*:[47]

> But the fact that the clause has been agreed between parties of equal bargaining power who have competent advice cannot be determinative. The question whether a clause is penal habitually arises in commercial contracts, which enjoy no immunity from the doctrine.

[106] That case involved one party who was "a key figure in the advertising and marketing world of the Middle East … one of the most influential business leaders in the Lebanon"[48] and another which was "a holding company within the WPP group, which is the world's largest market communications services group".[49] The agreement between these two parties had been the subject of extensive negotiations over six months. Both were represented by highly experienced lawyers. The relevant stipulation was nevertheless found to be penal.[50]

Admissible evidence

[107] Australian authority contemplates that, even where the attack is based on disproportionality principles alone,[51] a wide ranging inquiry is necessary, in turn based on a wide range of admissible evidence. In *Esanda Finance Corporation Ltd v Plessnig* Wilson and Toohey JJ stated:[52]

> The character of a clause as penal or compensatory is then to be perceived as a matter of degree depending on *all the circumstances, including the nature of the subject matter of the agreement*.
>
> (Emphasis added)

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45 *Yarra Capital Group Pty Ltd v Sklash Pty Ltd*, above n 30.
46 Refer to memorandum of 7 September 2015.
47 *Makdessi v Cavendish Square Holdings* BV, above n 38, at [75(v)].
48 At [2].
49 At [4].
50 The decision has been the subject of an appeal to the UK Supreme Court heard 21-23 July 2015. Judgment is currently reserved.
51 And a fortiori, it would appear, if the attack is on the basis of unconscionability.
52 *Esanda Finance Corporation Ltd v Plessnig* (1989) 166 CLR 131.

[108] As Cole J noted in *Multiplex*:[53]

> If one is to have regard to "all of the circumstances, including the nature of the subject matter of the agreement" in determining as a matter of degree whether a clause is penal or compensatory, one would need to know of the relationships between the parties at the time of the contract, the genesis of the clause, discussions concerning it, the bargaining position of the parties, whether they were each fully advised and whether, in all the circumstances the party now claiming the ineffectiveness of the clause, at the time of the contract appreciated the likely imposition under the clause in consequence of its breach yet nevertheless agreed to the clause presumably because the contract was perceived to be beneficial to him notwithstanding the existence of the liquidated damages clause.

[109] More recently Allsop CJ stated in *Paciacco* that the Court may have regard to:[54]

> [evidence concerning] the origin and evolution of the liquidated damages clause and, in particular, the reasons for its particular form, the discussions that had occurred regarding it and its object.

[110] In the course of the evidence, a difference emerged between Dr Peden and Mr Douglas in terms of whether a Justice of the Supreme Court of NSW would be entitled to take into account the uncommunicated views of the parties in determining whether a particular stipulation was a penalty. In her supplementary oral evidence Dr Peden stated that, although the process of construction engaged in to determine whether a stipulation is a penalty included evidence of surrounding circumstances and that in some cases the negotiations of the parties fell within that concept, this did not include "one party's subjective belief, instead it is the communicated views of the parties in their negotiations".

[111] Mr Douglas took issue with this in his supplementary brief. He relied on the following passage from the Chief Justice's judgment in *Paciocco*:[55]

> The primary Judge did not consider the material tendered about ANZ's state of mind to be relevant. In the context of dealing with the Late Payment fee, her Honour said that the inquiry as to whether a fee was a genuine pre-

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53 *Multiplex Constructions v Abgarus Pty Ltd* above n 37, at 512-513.

54 *Paciocco v ANZ Banking Group Ltd*, above n 8, at [209].

55 At [225]. See also [212] where His Honour referred to "all the circumstances and evidence tending to illuminate all the circumstances" as being admissible to assist with the process of characterisation as to whether the clause is penal or is a genuine pre-estimate of damage in the relevant sense.

estimate of damage was one that did not invite any inquiry into the parties' states of mind at the time of the contract: see [126] of the reasons.

With respect I do not agree. The views of the parties may well not conclude the inquiry but, as in *Clydebank*, with the correspondence between the parties, as in *Multiplex*, with the precontractual discussion of the parties, and as in *Dunlop*, with Mr Beazley's evidence of the purpose of the clause, the approach and purposes of the parties may be of some assistance and understanding of both what was intended and whether it had a legitimate commercial justification.

[112] In Mr Douglas' opinion, this portion of the judgment, taken together with the discussion which preceded it, makes it clear that the Full Court of the Federal Court considered that the subjective states of mind of the parties at the time of entering into the contract were relevant to the inquiry whether a fee had some legitimate commercial justification. Acknowledging that both the *Clydebank*[56] and *Multiplex* cases referred to by Allsop CJ in the passage quoted involved subjective views which *had* been communicated to the counter-party in some way, he stated that was not the case with Mr Baisley's views in *Dunlop* and, in any event, both the reasoning of Allsop CJ in *Paciocco* and the actual admission of evidence of ANZ's uncommunicated state of mind[57] militated against Dr Peden's narrower approach. Mr Douglas concluded:

In my opinion, the cases that are being referred to by Professor Peden, in the answer which she gave to Mr Hunter are not cases relating to the characterisation of the stipulation as a penalty. They are cases relating to the interpretation of contracts, which has been a very vexed area in Australia since the decision of *Codelfa Construction Pty Ltd v State Rail Authority of NSW*. In that regard, what she says is entirely correct, but it is not directly applicable to the question of the characterisation of a stipulation as a penalty and the evidence admissible for that purpose.

[113] Mr Douglas then referred to the very recent decision of Jackson J in *P T Thiess Contractors Indonesia v PT Arutmin Indonesia* and, in particular, the following passage at [190] of his Honour's judgment:

In my view, it is an error to treat the question of exorbitance, extravagance or oppression as subject to the parole evidence rule as to the admissibility of extrinsic evidence of the construction of a contract in writing.

56 *Clydebank Engineering and Shipbuilding Company Ltd v Don Jose Ramos Yzquierdo Y Castaned*, above n 32.

57 Said to be deterrence of customers breaking their account limits.

[114] In making that observation his Honour cited *Paciocco*[58] and also another very recent decision of the Queensland Supreme Court in *Grocon Constructors (QLD) Pty Ltd v Juniper Development No.2 Pty Ltd and Anor*.[59]

[115] Mr Douglas in turn noted that the *Grocon* case is itself based on two decisions of the Court of Appeal of NSW, *Luu v Soverign Developments Pty Limited,*[60] and *Fermiscan Pty Ltd v James*.[61]

[116] Referring to his earlier evidence in relation to the precedent value of various decisions before the NSW Supreme Court, Mr Douglas concluded that only in the event a NSW Supreme Court judge considered *Paciocco, Multiplex,*[62] and *Thiess* to be plainly wrong would they not be followed, and the very broad range of material which they recognise as relevant in the characterisation process not therefore be admitted.

[117] Mr Douglas says that there is no basis for suggesting the approaches are plainly wrong as they are supported by House of Lords authority. Moreover, in his opinion:

> … quite apart from any of these matters such a Judge [of the Supreme Court of NSW] would consider himself or herself bound by the two NSW Court of Appeal decisions of *Luu* and *Fermiscan* relied upon by both Queensland Judges as part of their reasons which would be binding on a first instance Judge in NSW.

[118] Mr Douglas was not cross-examined on his supplementary (or substantive) brief and I adopt his views as consistent with the authorities cited. To that end, I intend, in my assessment of whether the clause is penal or compensatory, to look at all of the surrounding circumstances, including the views or states of mind of the parties, whether communicated or not.

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58 *Paciocco v ANZ Banking Group Ltd*, above n 8, at [209], [211] – [212] and [225].

59 *Grocon Constructors (QLD) Pty Ltd v Juniper Development No.2 Pty Ltd and Anor* [2015] QSC 102 at [116].

60 *Luu v Soverign Developments Pty Ltd* [2006] NSWCA 40, (2006) 12 BPR 23, 629.

61 *Fermiscan Pty Ltd v James* [2009] NSWCA 355; (2009) 261 ALR 408 at [133] – [134].

62 Which he says would be regarded as highly persuasive being a decision of a well known commercial Judge, subsequently a Judge of Appeal in New South Wales.

The MGM issue

[119] The issue in this respect is whether the penalty doctrine is engaged at all. The answer depends on whether Late Payment fee is a collateral/accessory clause or whether it is in fact a part of the bargain for another right – in effect the agreed price for continuing to provide the loan funds beyond 26 October 2012. Dr Peden summarised the issue as follows:

> [O]n the agreement as set out, are there in fact two primary obligations to pay separate sums of money, or is there one primary obligation to do something, failing which another sum will be payable.

[120] The issue is one of construction which, as invited to do, I approach in accordance with the principles set out in the standard authorities including *Vector Gas Limited v Bay of Plenty Energy* and *Investors Compensation Scheme Ltd v West Bromwich Building Society*.[63] Neither Mr Gedye QC nor Mr Hunter contended that this was a case requiring exploration of the more nuanced issues which have emerged from these authorities. I approach the matter on the basis that even words with an apparently plain and unambiguous meaning must be considered within the so called factual matrix given that such words, devoid of external context, may not ultimately be what a reasonable person aware of all the relevant circumstances would consider the parties intended their words to mean.[64] However, the proscription on taking into account the subjective views of the parties is one usefully emphasised, particularly in a case such as this where Wilaci placed significant emphasis on Mr Kerr's claims, immediately before and after default, that the agreement provided for "flexibility" in the repayment date by virtue of the weekly Late Payment fee.

[121] The leading Australian Authority is that of the New South Wales Court of Appeal in *Metro-Goldwyn-Mayer Pty Ltd v Greenham*.[65] In that case exhibitors of films were permitted to screen the films once, at a designated time in return for the payment of a hireage fee. Clause 56A of the relevant contract provided that:

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63 *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1997] UKHC 28; [1998] All ER 98.

64 *Vector Gas Ltd v Bay of Plenty Energy Ltd*, above n 11, at [4] per Blanchard J, [22] per Tipping J and [64] per McGrath J.

65 *Metro-Goldwyn-Mayer Pty Ltd v Greenham*, above n 12.

> If the exhibitor without the consent in writing of the Distributor exhibits or permits to be exhibited any film on or at any date or time or at any place not authorised by this Agreement the exhibitor shall pay as hire for each such exhibition four times the amount of the hire calculated in accordance with clause 54 as at each day on which the film was so exhibited or permitted to be exhibited were an authorised exhibition date on which the Exhibitor without excuse had failed to exhibit.

[122] The defendant exhibited the films on 12 "unauthorised" occasions in respect of which MGM sued for four times the hiring fee for each such screening. It was met by an argument that such sums were irrecoverable as a penalty.

[123] At first instance this defence was successful. By a majority the Court of Appeal held that, on its true construction, the relevant clause provided the hirer with the option of rescreening the film provided he paid an additional hiring fee and that it was not, therefore, in the nature of a penalty. Despite a consent position in the Court below, it held that there was no breach of the agreement as a result of the defendant rescreening the film and, accordingly, the question of whether the payment represented a penalty or unliquidated damages was not engaged. The majority judgments were given by Jacobs JA and Holmes JA. At page 723 the former stated:

> Upon such an approach it seems to me that clause 56 is properly regarded as one providing for an additional hiring fee in the event of an additional showing of a film. It may well be intended by the agreement that such an additional showing should be strongly discouraged. For this reason a very large hiring fee compared with the original hiring fee is provided. However that does not make the clause a penalty clause… First it would be necessary to determine that cl 56(a) truly dealt with damages and not with hire of the film for a further occasion or occasions. In the light of the interpretation that I have given to the agreement I do not see how, despite the language of clause 9, the clause in question can be regarded as a clause dealing with damages. There is no right in the exhibitor to use the film otherwise than on an authorised occasion. If he does so then he must be taken to have exercised an option to do so under the agreement if the agreement so provides. The agreement provides that he may exercise such an option in one event only, namely he pay a hiring fee of four times the usual hiring fee. In my view this is not a clause dealing with damages but is dealing with the price of such an option.

[124] His Honour went on to note that, if this were not the case, an exhibitor who showed the film at an additional time would be liable in conversion, and thus for example liable for the loss or destruction of the film irrespective of negligence which

he said, "would be to part a long way from the intention of the words used in the standard form of contract".[66]

[125] Holmes JA in turn held:[67]

> I am of the opinion therefore that cl 56 does not relate to the breaches of the agreement and the law with respect to liquidated damages and penalties, as developed in the common law, have no application to the agreement.

[126] In the result, the outcome was dictated by a close reading of the relevant provision. Although screenings outside the stipulated time were not authorised, neither were they regarded as being in breach. The contract on its proper construction facilitated such showings, albeit for an additional and substantially increased fee.

[127] Turning to the present case I start my analysis with the terms of the contract.

[128] In that respect Torchlight differentiates between the facility fee (a one off fee to be paid regardless of when the loan is repaid), the Interest Rate and Default Rate (which are contractually the same rate) and the Late Payment fee which it says is a separate obligation which applies when the principal is not paid on the date of final payment.

[129] It says, relying on the pleadings and the agreed Statement of Facts, that the final payment date was 26 October 2012. It relies on what it calls the plain meaning of the contract to say that the Loan Agreement made no provision for the flexibility that Torchlight contended for ex post facto and that, if the case had arisen in different circumstances and Torchlight was arguing for some right to repay "flexibly", that contention would not even reach the arguable case threshold necessary to defeat summary judgment. It says that no amount of wishful thinking on the part of Torchlight in 2012 can change that basic reality. It was a Loan Agreement with a fixed repayment date giving rise to potentially draconian consequences in the event of default. It was not an "equity bridge", "repo agreement", "partnership", or whatever else Torchlight might have hoped it to be.

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66 At 724.
67 At 727.

[130] Wilaci contends that the terms of the contract do not preclude a finding that the fee was, in substance, a fee for further accommodation. It accepts that non-payment on due date was an event of default and a breach of the requirements in clause 3.1. However, it says that the late fee provisions are not expressed to engage *as a result of* a breach of clause 3.1 or an event of default. It says that it is not the fact of a breach which is stated to give rise to the payment and, in fact, the money continued to be held by the borrower. It says that clause 3.8 recognises that the loan money may continue to be enjoyed by the borrower after due date (as a matter of fact) and the lender may remain unpaid. It then goes on to say that in its full factual context, to which I will return shortly, the fee is appropriately recognised as the agreed price for continuing provision of funds.

[131] I consider the position in this case materially different from that in *Metro-Goldwyn-Mayer* by virtue of the fact that it is undisputed that a failure to repay on 26 October 2012 gave rise to a breach of the agreement and an event of default. There was no option to extend beyond that date as the majority of the Court of Appeal in MGM was able to identify on the particular wording of 56(a). That wording did not, in the majority view, amount to a prohibition but rather defined the terms on which the option might be exercised. Although as Wilaci argues, the fact of having breached a term does not *necessarily* preclude the provision of further services or the requirement to pay for them, where an obligation arises on and contemporaneously with breach it will, in my view, typically be referable to the breach and in that sense collateral to it rather than arising independently. I see nothing in the particular words of this contract which suggest any different result. The reference to the date of *final* payment militates strongly against the construction for which Wilaci contends.

[132] I find compelling Torchlight's argument that it would be unable to have resisted 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". If, as I believe, any such resistance would have been futile, it is difficult to see why a different approach should inform the MGM issue.

[133] Nor, having regard to the admissible factual context do I consider any alternative construction of the relevant provision is required. In particular:

(i) There was no mention of flexibility prior to the parties' agreeing to the terms of the Loan Agreement. Mr Skidmore reassured Mr Grill in numerous emails that he had "a solution that guarantees $37 M to be … payable on the 60th day", "on day 60 the $37 M will be paid out and extinguished" and that he was "100 per cent confident of the fact that you will exit this in 60 days time".

(ii) The whole premise of Mr Grill's desire to "incentivise" repayment on day 60 was to ensure that Wilaci got its money back at that time.

(iii) At no stage, either in the correspondence which passed between the parties before or after due date, or in his evidence at trial did Mr Grill give any indication that the plaintiff had flexibility to repay the money late or that the Late Payment fee had been agreed as the price of that flexibility. To the contrary, his approach, part cajoling, part encouraging, part threatening, was to endeavour to achieve repayment as quickly as possible against what was identified as an event of default. His email to Mr Kerr of 11 December 2012 at 8.55 am summarises his position in terms:

> It is good that you now acknowledge that the $500 K per week applies after 60 days. Your previous unwillingness to acknowledge this has been a major point of disagreement.
>
> Payment of the $5m fee on the 27th is fine. The date the interest payment was due is, I believe, clear in our agreement.
>
> I am advised that you went into default under the agreement when you did not repay the loan on the due date i.e after 60 days.
>
> 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.

(iv) Whatever flexibility Torchlight wanted or convinced itself it had is, in my view, irrelevant in that context. The fact is that it never had such flexibility. It was, as Mr Grill himself said in "default" from 26 October 2012.

(v) The case is not therefore one where subsequent conduct can be called in aid of the construction exercise I am required to undertake.[68] This conduct does not disclose any of the shared intention required. The ironic fact that Torchlight and Wilaci now find themselves on the opposite side of the argument each was promoting at the end of 2012 does not change that result.

[134] For the foregoing reasons I reject Wilaci's argument on the MGM issue.

Penal or compensatory?

[135] I turn now to consider whether the clause is penal in character.[69] As Lord Dunedin said in *Dunlop*:[70]

> The essence of a penalty is money stipulated as *in terrorem* of the offending party; the essence of the liquidated damages is a genuine covenant pre-estimate of damage.

Plaintiff's submissions

[136] Torchlight submits that this is in fact one of the easier penalty cases to come before the courts. Whereas in many (*Paciocco* being a classic example) a complex and detailed analysis may be necessary to determine whether a clause is penal in character, it says that, in this case, the evidence is irrefutable that the Late Payment fee was set for the purposes of incentivising the payment or, to use Mr Grill's actual words "to provide enough incentive to make sure the deal gets settled within 60 days".

[137] To similar effect is Mr Jeston's observation to Mr Grill in an email enclosing his due diligence note where he refers to the default terms as being "strong and provid[ing] sufficient impetus to ensure Torchlight is focused on repaying you on

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68 *Wholesale Distributors v Gibbons Holdings* [2007] NZSC 37, [2008] 1 NZLR 277 eg at [52].
69 *Paciocco v ANZ Banking Group Ltd*, above n 8, at [95].
70 *Dunlop Pneumatic Tyre Company Ltd v New Garage and Motor Company Ltd*, above n 13, at 86.

time…" And likewise Mr Skidmore referred to the "aim" of the payment as being "to incentivise settlement on day 60".

[138] Accordingly Torchlight says that the dominant purpose of the clause was self-evidently *in terrorem* and that this of itself answers the characterisation issue the Court is obliged to undertake. It says that such character is frankly recognised in contemporary correspondence which refers to the payment as a "penalty".

[139] I do not regard that particular reference as determinative (albeit telling). The authorities make it clear that the question of whether a provision is penal is to be approached as one of substance not form. Moreover, as Wilaci points out there are other contemporaneous references which refer to the payment in more neutral terms, including Mr Jeston's reference to "default interest" or "new default payment terms". The reference to the aim or purposes of the payment by each of Mr Skidmore, Mr Gill and Mr Jeston are, in my view, more significant.

[140] As a corollary to its proposition that the payment was and was always intended to be *in terrorem*, Torchlight states that the fee did not constitute a genuine pre-estimate of loss in the relevant sense. It says that the relevant comparison for the purposes of Lord Dunedin's test 4(a) is between:

(i) AUD 500,000 per week (which it emphasises, albeit obviously is AUD 26M per year); and

(ii) The damages that Wilaci was likely to suffer if the loan was not repaid on time.

In that respect it adopts the approach in *Ringrow Pty Ltd*, which I have already identified as applicable.

[141] Torchlight accepts that the likely damage is to be assessed *ex ante* but says this does not preclude reference to the losses which have in fact been suffered, relying on *Phillips Hong Kong Ltd v Attorney-General of Hong Kong*.[71]

[142] It says that Wilaci's likely loss was its ongoing interest cost to Credit Suisse which was, in any event, covered by the 150 basis point margin specified in the Loan Agreement. That cost was a variable one but averaged around five per cent per annum. Thus, on an *ex ante* basis it says Wilaci's loss in the event of late payment could be anticipated to be in the order of $35,500 per week in respect of which the late penalty fee represented a multiple of approximately 14. It points out that for the period that the loan or part thereof was overdue Wilaci actually incurred additional interest costs of approximately AUD 1.8m and compares that with its prayer for relief on the counterclaim in which it seeks default interest of approximately AUD 2.6m and Late Payment fees of approximately AUD 31.3m, in total approximately 19 times its actual loss. That of course involves an *ex post* analysis with which care is required.

[143] Torchlight acknowledges that the formulation in *Ringrow Pty Ltd* would be sufficient to capture any reasonably anticipated increases in Credit Suisse's interest rate (although in fact interest rates fell over the relevant period) but it says that the other losses to which Wilaci refers are entirely fanciful.

[144] These potential losses were traversed by Mr Grill in his brief of evidence. He emphasised the fact that the loan was financed by borrowings from Credit Suisse backed by WorleyParsons shares which meant that Wilaci was vulnerable both to changes in Credit Suisse's security or LVR policies (his recollection was that such charges had actually occurred), or to a decline in the value of the shares. In that context he emphasised the potential for a borrower to have to put up more security or reduce the loan balance (either of which may not be possible) in which event the secured shares would have to be sold. This he described as a "disastrous scenario" because the catalyst would typically be a decline in share values, giving rise to a forced sale on a low or falling market. Moreover, with such a large parcel to be

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71 *Phillips Hong Kong Ltd v Attorney-General of Hong Kong* [1993] UKPC 3, [1993] 61 BLR 41 at [59].

disposed of by Credit Suisse in forced sale conditions, the price might be depressed further. As such, he said, there was potential for value to be permanently destroyed, possibly on a huge scale. He also stated that any sale on a forced basis would have been extremely unfortunate, not only for his personal reputation but for that of WorleyParsons of which he was CEO at the time (and later chairman). He emphasised his ability to predict, with reasonable accuracy, share movements over the 60 day term of the loan but his vulnerability in the context of any extended repayment programme.

[145] Torchlight's response to this is that it defies reality. It says that Mr Grill and his interests had very substantial assets, that he was ranked by Forbes magazine as being the 28th wealthiest Australian in 2012 with net assets of approximately AUD 800m and by Business Review Weekly in the same year as having assets of approximately AUD 780m. It says that the Credit Suisse arrangements involved a pledge of only 3.5 million shares in WorleyParsons against the 25 million shares acknowledged to be held by his interests. Although the number of shares pledged subsequently rose to 4.6 million Torchlight emphasises that this was at least in part due to an increase in the loan facility to AUD 43m for reasons unconnected with the Torchlight arrangements (the evidence was that Mr Grill had made a substantial draw-down against the facility at the end of 2012 to fund a holiday home in Whale Beach). So, it says, Wilaci never pledged more than 18 per cent of its WorleyParsons shares to Credit Suisse and there were at all times very substantial margins available in terms of both security and serviceability. It points to Mr Skidmore's initial email to Mr Grill regarding the transaction in terms that it was "small albeit juicy". It says that this correctly characterises the size of the transaction for someone of Mr Grill's very considerable wealth, a fact of which Mr Skidmore was aware from past dealings. It says therefore that Mr Grill was more than capable of paying down the loan if required from other sources (as he in fact did) or refinancing it and that the idea that Wilaci would have been forced to sell WorleyParsons shares, in the context of its actual position is, "pure fantasy". It draws the distinction between Wilaci's speculation about possible losses and the approach in *Paciocco* where the ANZ identified concrete losses in the form of additional regulatory capital costs and collection costs that it was likely to suffer in the event of late payment.

[146] Addressing an argument on which Wilaci placed significant emphasis, Torchlight next says that the fact the Late Payment fee, expressed as an annualised percentage, was approximately 12 per cent less than the AUD 5m 60 day facility fee (again expressed on an annualised basis[72]) is irrelevant. That is because it says Wilaci expressly disavowed any suggestion that it was in the business of money lending and does not point to any foreseeable opportunities (or indeed any unforeseen ones) which it was deprived of while the loan was outstanding. It says that the AUD 5m facility fee cannot, in any event, be equated to an interest rate or the cost to Wilaci of lending the money for a short period. It was, it says a "one-off" and in the nature of a profit participation as Mr Skidmore explained in his evidence in terms:

> What it [the deal] actually involves $37m out of John's coffers straightaway which you have to borrow to come up with. He then gave the $37m …. to Torchlight and Torchlight, you know, in the various ownership structures of PGC and things like that, they were then able to privatise that vehicle, which gave that $10m uplift that we spoke of, which is where he [Mr Grill] got his $5m.
>
> $10m bucks uplift and that is where the $5 million yeah comes from in terms of the profit participation".

[147] Torchlight contrasts this profit participation with the Late Payment fee which had a separate and identifiable purpose – namely "incentivising" repayment or due date.

[148] Finally, Torchlight addresses what it acknowledges as its sophisticated commercial position, emphasising the extract from *Makdessi* previously referred to and the facts of that case. It says that although courts will generally seek to uphold commercial bargains, it is in precisely that context that the penalty doctrine habitually arises. While acknowledging its sophistication, Torchlight also emphasises the difficult financial position it was in at the time.

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72 The relevant comparison is 82.19 per cent per annum and 70.27 per cent per annum.

Defendant's submissions

[149] Wilaci emphasises, correctly, that the onus is on Torchlight and freedom of contract is an important consideration.[73]

[150] In the characterisation of the Late Payment fee as penal or compensatory it emphasises that:

(i) The assessment must be made *ex ante*;

(ii) Relying on *Phillips Hong Kong Ltd v Attorney-General of Hong Kong*, that evidence of conduct subsequent to formation may throw light on the position as at formation;

(iii) Characterisation is not decided on the construction of the contract alone and evidence of surrounding circumstances is admissible to show the stipulation's real character;

(iv) The task is one of construction in a wide sense falling to be decided on the meaning and content of the words and on the inherent circumstances of each particular contract – a process which is neither mechanical nor sequential.

[151] It emphasises that the true reference point against which to assess losses, extravagance or unconscionability is the nature and extent of Wilaci's interest in the due performance of the obligation, adopting the approach in *Paciocco*.

[152] Focusing first on the terms of the Loan Agreement, Wilaci says that there is nothing to characterise the fee as serving only as a security or deterrent. It says that the fee does not operate arbitrarily in the event of breach regardless of scale or significance because there is a direct value relationship between the late fee and the level of principal remaining unpaid. It also says there is a direct time relationship in that the fee is payable only for the same period that the principal remains unpaid. In that sense it says the fee has the essential characteristics of default interest and is

73 Relying on *Yarra Capital Group Pty Ltd v Sklash Pty Ltd*, above n 30, at [11].

therefore prima facie a compensatory provision. It notes that, at the point the late fee was introduced in the agreement, the previous 500 basis point default rate was removed.

[153] It also places significant emphasis on the fact the Late Payment fee was, in percentage terms, lower than the initial fee. It emphasises Mr Grill's evidence of contemporaneous calculations that at AUD 500,000 the Late Payment fee was somewhat less on a weekly basis than the AUD 5m initial fee calculated over the 60 day term. Although that calculation was uncommunicated to Torchlight, Wilaci submits that it was dealing with someone for whom the arithmetic was elementary and Mr Grill's own calculations are admissible extrinsic evidence in characterisation of the Late Payment fee.

[154] It makes the valid point that the size of the late fee claimed (circa AUD 31m) is simply a function of the length of time for which the advance was outstanding despite numerous promises to the contrary, and that it was always within Torchlight's power to ensure the claim was at very much modest levels. I do not intend to be overwhelmed by the size of the claim in total dollar terms, focusing instead on the purpose for imposition of the term and whether, expressed as a weekly sum, it represented a genuine pre-estimate in the relevant sense.

[155] I accept also Wilaci's position that the Court should be wary of any attempt to make the fee appear oppressive or extravagant by characterising it on an annularised percentage basis when that was not the approach the parties themselves adopted.

[156] Wilaci then says that an important category of evidence in assessing whether the clause was penal or compensatory are the many statements made by Mr Kerr in the period after due date alleging that the late fee was the price for further accommodation. As such it draws on the same evidence as relied on in the context of the MGM issue. It says that such statements are not relied on simply as admissions that the debt is owed but rather as expressions by the party to be charged of what was intended by the Late Payment fee provisions and what commercial sense they made.

[157] I consider that evidence to be of limited value. Although *Phillips Hong Kong Ltd* permits examination of actual loss as evidence of what could reasonably be expected to be loss at the time the contract was made it is not authority for recharacterisation of a term based on the comments of one party (with an obvious vested interest in delaying repayment) made after the contract was entered into. Moreover, if that submission is intended to invoke the "new approach" referred to in some of the recent English authorities and discussed in footnote [48] above then the point is, I think, appropriately made that those cases are focused on the extent to which there is a commercial rationale for the difference between the amount payable on breach of the agreement and the amount which would be payable if the claim for damages was brought at common law. Unilateral claims to an "equity bridge" do not, in my view, assist that inquiry.

[158] In a proposition which I accept, Wilaci then says that the characterisation issue involves an assessment of the relationship between the parties at the time of the contract, the genesis of the clause, the discussions concerning it and the bargaining position of the parties and related matters. It says that Mr Kerr was sophisticated and experienced in business and that Torchlight was in receipt of financial and legal advice throughout. Both propositions are self-evident. By contrast, it says that although Mr Grill was a highly experienced businessman, Wilaci was not structured or resourced to act as a commercial lender. It says that the loan was highly risky and the security by way of GSA was inadequate in that there was no direct security over the underlying assets held or controlled by Torchlight. Its position in that respect was supported by the evidence of expert witness Mr Symonds who described the transaction as "off the scale" in terms of risk, and not one which any commercial lender would have touched regardless of fees. He was also particularly critical of the security arrangements which he described as: "very unsatisfactory and inadequate because it did not prevent dealings with the assets or distribution of proceeds of sale, it did not enable specific enforcement against assets in the event of fraud" and "would not have stopped Torchlight encumbering assets or transferring them to another entity".

[159] In relation to the surrounding circumstances, Wilaci further says that the Late Payment fee was freely negotiated and was in fact first offered by Torchlight in an

attempt to persuade Mr Grill to proceed. If, as I find, that was with Torchlight's authority, Wilaci suggests that characterisation of the Late Payment fee as extravagant is a much harder proposition for the plaintiff to sustain.

[160] In summary, therefore, it describes the circumstances at the time of formation of the contract as involving a unique, high value, risky and off-market transaction where both parties should be free to set whatever terms they wished and that the case is at the opposite end of the factual spectrum to cases with the consumer protection flavour of *Andrews* and *Paciocco*.

[161] In relation to the assessment of the damage likely to be caused by the breach, Wilaci rejects what it calls Torchlight's narrow approach based on the reasonable contemplation of those losses at the time the contract was entered into. It says that such an approach is wrong under NSW law which provides for a broader inquiry based on the obligee's interest in the due performance of the obligation. It says that, in any event, damages in this case would always be difficult to assess in that there was a range of potentially serious consequences not amenable to ready monetary calculations including the loss of the shares pledged as security to Credit Suisse and reputational harm resulting from any such enforcement action.

[162] I consider that care is, however, necessary in this respect. Principle 4(d) in *Dunlop* is directed to difficulties in quantification of recoverable loss. It is not an invitation to ignore principles of remoteness in respect of the type of loss which is recoverable (and against which the comparison in principle 4(a) is to be conducted).

[163] In respect of Wilaci's interest in the due performance of the obligation, it focuses on its desire to maintain a risk profile appropriate to a 60 day advance. I will return to the submission in more detail later in this judgment.

[164] In relation to extravagance, Wilaci says that whether there is any element of oppression or unconscionability should inform the question of whether the fee is extravagant and that neither were demonstrated by Torchlight on the facts. Indeed, it suggests that this was the case of:

> … commerce in its purest form. There was a buyer and seller, both of whom were willing and both of whom saw justification and benefits in the contract terms. Neither was suffering from any disability. Both were sophisticated and it is difficult to contemplate a transaction or a fee term further removed from the inherent elements of oppression or unconscionability".

[165] I consider that a fair overall assessment of the relationship of the parties and note that Torchlight's claim is not based on oppression or unconscionability as stand alone concepts. Nor did it challenge the Late Payment fee (unlike, until the eve of trial, the AUD 5m facility fee) under s 12CB of the ASIC Act as would inevitably have occurred if oppression had been seriously arguable. As previously indicated, oppression only arises in this case in a *Multiplex* sense, namely as a function of disproportionality between agreed sum and genuine pre-estimate of the damage likely to be caused by the breach.[74]

Analysis

[166] I accept that this is to some extent an unusual case in that it is characterised by unambiguous statements by the obligee (and intermediary Mr Skidmore) about the aim or purpose of the Late Payment fee. Whether, when the relevant exchanges took place between Mr Grill and Mr Skidmore, the latter was acting as an agent of Torchlight is accepted by the parties as ultimately immaterial. He was, I find, certainly acting on Torchlight's authority. The parties' reasons for agreeing the relevant term are undoubtedly part of the surrounding circumstances legitimately considered in a characterisation process[75] and both Mr Skidmore's and Mr Grill's reasons were clear – the aim was to incentivise repayment on due date.

[167] Resolving the dichotomy which Lord Dunedin draws between the essence of penalty – a payment of monies stipulated *in terrorem*, and liquidated damages – a genuine pre-estimate of damage, will typically, as *Dunlop* itself recognises, necessitate a comparison between the sum stipulated and recoverable loss, and an assessment of whether the former is extravagant in comparison to the latter. If it is, then the essential question is answered – the payment is considered *in terrorem*. But that dichotomy might be more simply answered by direct evidence that the purpose of the collateral stipulation was to enforce performance of repayment.

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[74] *Paciocco v ANZ Banking Group Ltd,* above n 8, at [102] – [106].
[75] See the extract from *Paciocco* cited at [109].

[168] One of the clearest statements in this respect appears in the judgment of Arden LJ in the English Court of Appeal decision of *Murray v Leisureplay Plc*,[76] a case to which Mr Douglas QC refers. Although, in respect of other aspects of Arden LJ's judgment, Buxton and Clark LJJ took a broader approach, their comments were not directed to the specific passage I refer to.[77] Ardern LJ stated, as one of the questions which a Court should ask itself following identification of the amount payable on breach, the amount which would be payable if a claim was brought at common law and the reasons for agreeing the relevant clause:

> Has the party who seeks to establish that the clause is a penalty shown that the amount payable under the clause was imposed in terrorem *or* that it does not constitute a genuine pre-estimate of the loss for the purposes of the *Dunlop* case …?
>
> (Emphasis added)

[169] Likewise in *Paciocco* the Chief Justice identified that if the "clear contractual purpose"[78] was coercion of performance by the payment or forfeiture of a large amount of money the doctrine will engage irrespective of the Court's general deference to bargains entered into by commercial parties.

[170] Mr Grill may well have, as he says, made a quick calculation that, AUD 500,000 per week, the Late Payment fee was not materially different, expressed in either percentage or weekly terms, from the fee which he had secured for the initial term. The arithmetic was not hard. But his stated purpose in imposing the Late Payment fee had nothing to do with any assessment of loss on his part. It was to "incentivise" repayment – the very essence of an *in terrorem* obligation. Nor do I consider the plaintiff's initial proposal on 17 August 2012 that there be an "immediate $1m AUD" payment on default and a further AUD 1m per month for each month thereafter that the facility remained outstanding affects this part of the analysis. That offer was, as Mr Skidmore put it and I find, a "sweetner" when Torchlight's initiatives seemed otherwise to be gaining little traction. A payment is no less "*in terrorem*" for the fact that the payer may initially propose it, especially where the payer itself acknowledges an *in terrorem* purpose. Tellingly, although I

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76 *Murray v Leisureplay Plc* [2005] EWCA Civ 963, [2005] IRLR 946.

77 Note, however, the endorsement of Arden LJ's approach by unanimous Court of Appeal in *Makdessi v Cavendish Square Holdings BV*, above n 38 at [124].

78 *Paciocco v ANZ Banking Group Ltd*, above n 8, at [187].

accept not decisively, Mr Skidmore's email of 17 August identified both the initial and monthly payments as "penalties". He used the term again in his exchanges with Mr Grill a week later.

[171] Tellingly also, Mr Grill opened his negotiations on this point at the level of AUD 1m per week. There is no suggestion that this equated with any calculation on his part, either in terms of loss or equivalence with anticipated returns absent default. It was simply an impost sufficiently draconian to concentrate Torchlight's mind on the importance of timely repayment. The same motivation is apparent in the fee ultimately settled.

[172] I therefore find that the Late Payment fee was as a fact (and adopting the words of Arden LJ in *Leisureplay*) "imposed *in terrorem*" and its "predominant function"[79] was deterrence. The consequences are ones I greet with some reluctance. Torchlight is a sophisticated party. Its early dealings with Mr Grill were characterised by obfuscation around the real requirements for the money (although I accept the fact of the RCL related commitment was ultimately disclosed). Although Mr Skidmore had described Torchlight as having "committed but not called for contributions of AUD 15m which you will have an automatic call on on day 59" there was an understandable desire on the part of Mr Grill to ensure he got repaid in a timely fashion and thus to "incentivise" that repayment. But all that does is underscore the reasons for imposition of the clause which was *in terrorem*.

[173] I turn then to consider whether, if the payment is not appropriately considered unenforceable for the reasons indicated, it is nevertheless unenforceable as not constituting a genuine pre-estimate of loss in the relevant sense. I accept that, in this context, there is no requirement on the part of the obligee to demonstrate contemporaneous calculations supporting a loss assessment. To that extent the concept of "genuine pre-estimate" is something of a misnomer. Rather, the approach of the authorities, either binding or highly persuasive in this case, is to consider whether the required payment is extravagant or exorbitant in comparison with the loss likely to be caused by the breach. If not, then the doctrine does not apply. As the Chief Justice said in *Paciocco*: genuine pre-estimate is in this sense an

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[79] To use the phrase in *Makdessi v Cavendish Square Holdings BV*, above n 38 at [124].

"objective reflex of a penalty" – a "payment on breach or failure of a collateral stipulation that is not proved to be extravagant or exorbitant".[80]

[174] On an orthodox measure of recoverable losses I accept Torchlight's submission that there was a sufficient disproportion between such losses and the amount of the Late Payment fee to constitute the latter "extravagant".

[175] There is no doubt that Wilaci's Credit Suisse funding arrangements were known to Torchlight and as such there was actual knowledge outside the usual course of things such that a breach of those special circumstances would be liable to cause more loss.[81] So the second limb in *Hadley v Baxendale* is engaged in terms of loss which may "reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as a probable result of the breach of it".[82] But this exposes the difficulty which Wilaci would have faced, applying orthodox principles of remoteness, in recovering many of the losses which it suggests *could* have flowed from the plaintiff's breach.

[176] Mr Grill and his related interests were substantial. Although he described the 2012 Forbes Rich List assessment of his wealth at AUD 800m as variously "very optimistic" and "wildly wrong", he suggested that he had "never had any question with the Business Review Weekly numbers", which, in final submissions, Torchlight identified as AUD 780m in 2012. However, that figure was not specifically put to him and Mr Grill's rejection of what was a very similar figure in the Forbes List leaves me uncertain as to whether his concession was properly made. Nevertheless, he was at the time clearly a very wealthy man with his interests holding a WorleyParsons share portfolio itself worth AUD 500m. Substantial dividend flows from that source were evidenced in the proceedings.

[177] I have no doubt also that both his home and his beach house were appropriate to a man of his success. He had previously been in a position where he could undertake what was ultimately a NZD 27m transaction with Mr Pye, a fact known to

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80 *Paciocco v ANZ Banking Group Ltd*, above n 8, at [140].

81 I use the words of *Hadley v Baxendale* (1854) 9 Exch 341 at 354 and *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd* [1949] 2 KB 528 at 539.

82 *Hadley v Baxendale* at 355.

the plaintiff. He inhabited a realm where a proposed AUD 37m transaction could be described by someone (with general familiarity of his financial affairs) as "small".

[178] Against that background, I agree with Torchlight that many of the potential losses postulated by Wilaci could never be said to have been, in the words of *Ringrow*,[83] "likely to be caused by the breach", or as Dr Peden expressed it, in the category of "losses likely to flow".[84] Mr Grill's obvious competence in business together with his clear appreciation of the volatility of share markets (he referred to WorleyParsons shares having hit a high of AUD 54.19 on 7 December 2007 before dropping, post GFC, to AUD 12.50 and then recovering to their 2012 values), and his evidence of a colleague who had taken a margin loan and been required to dispose of a large parcel of shares at post-GFC lows, persuade me that he would never have entered into the Credit Suisse arrangements if he thought there was any realistic possibility of the very pessimistic scenarios he now advances. He and his interests held a very substantial number of unencumbered shares. Even allowing for additional borrowings to fund acquisition of a multi-million dollar beach house and suggested changes in Credit Suisse's security criteria, only a small percentage of available shares were ever pledged. There were obvious flexibilities in his position.

[179] Only in the event of some catastrophic decline in the value of WorleyParsons' shares would any issue have arisen and then only if other assets held by his interests were similarly affected. Such "doomsday" scenarios, while always possible to speculate on, do not form the proper basis of a remoteness assessment.

[180] Nor in my view is it appropriate to include, for the purposes of the relevant inquiry, loss of the principal sum. It can be safely assumed that this was never identified as a probable result of failure to make timely repayment. The Wilaci interests would never have entered into the transaction on that basis.

[181] In my view, at the time the contract was made what the parties could have reasonably expected to occur in the event of a failure to repay on 26 October 2012, mirrors closely what actually occurred. The Credit Suisse facility would continue,

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83 *Ringrow Pty Ltd v BP Australia Pty Ltd*, above n 14, at [10].
84 NOE 2/26.

with possible adjustments to security levels reflecting a predictable range of market variations in share price, all of which Wilaci would be able comfortably to satisfy. Dividend streams against pledged shares would be paid to Credit Suisse directly in part or in whole meeting serviceability requirements. Other income (including from unpledged shares) would be applied to the facility from time to time. Further draw downs might be made against the facility to finance other requirements. The prospect of a forced sale of the share parcel at depressed prices and with the attendant embarrassment which Mr Grill referred to in his evidence was simply never realistically on the radar, nor would Mr Grill have entertained the transaction if it had been. This is a case therefore where as in *Phillips Hong Kong*:[85]

> What actually happened subsequently … can provide valuable evidence as to what could reasonably be expected to be the loss at the time the contract was made.

[182] In that context the loss likely to be caused by the breach and mutually contemplated as such was, in my view, Wilaci's ongoing interest cost to Credit Suisse (covered with a margin of 150 basis points by the contract's interest rate provisions, application of which is not disputed in the proceedings).

[183] Such an approach is consistent with the position under Australian Law described by Dr Peden in terms:

> Where the breach is a failure to repay the loan money on time, … the measure of loss for the purposes of a damages award would be a sum to compensate for the loss to the lender of the use of the money.[86]

[184] It is also consistent with the recent English Commercial Court decision in *Equitas Limited & Ors v Walsham Brothers and Co Ltd*[87] which Torchlight relied on in its submissions. At [123(iii)] the Court said:

> A solvent claimant who seeks to recover damages which exceed the cost of borrowing to replace the money of which it has been deprived is likely to be met with the defence that the claim is too remote or that it has failed to mitigate by borrowing in order to replace the money lost, in which case its recovery may be limited to that borrowing cost…

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85 *Phillips Hong Kong Ltd v Attorney-General of Hong Kong*, above n 71, at [59].

86 Prior to trial the paragraph in which this extract appears was challenged as inadmissible but the point was not taken further at trial. I would in any event have dismissed the objection.

87 *Equitas Ltd & Ors v Walsham Brothers and Co Ltd* [2013] EWHC 3264 (Comm).

[185] Wilaci was demonstrably solvent.

[186] However, it contends that in addition to such losses the Court should, for example, take into account recovery costs associated with any receivership. It says that such costs would, from an *ex ante* perspective, be inherently difficult to quantify and thus squarely within what *Dunlop* contemplated as a genuine pre-estimate of loss. In my view however, it could never have been anticipated that such costs would represent even a meaningful fraction of the Late Payment fee. At AUD 2.166m per month that fee was undoubtedly extravagant in relation to any such loss. Moreover, a lender would ordinarily look to its security for satisfaction of receiver's fees not a late payment provision. The fact such fees are being incurred assumes, *ex hypothesi* the ability to control and/or realise such assets.

[187] In summary therefore, I consider the Late Payment fee so significantly exceeds the loss likely to be caused by the breach that it qualifies as extravagant and therefore unenforceable. There may be some room for argument around the margins in terms of Torchlight's claim that the total recovery sought is approximately 19 times Wilaci's actual loss. That calculation involves addition of the contracted default (and ordinary) interest rate to the Late Payment fee which I do not consider valid for comparison purposes and, despite the encouragement received from the passage in *Phillips Hong Kong* referred to in [169] , focuses unduly on the *ex post* position. But there is no doubt that the fee exceeded by a multiple of many times what I consider to have been the recoverable loss assessed *ex ante*.

[188] However, Wilaci makes the valid point that, on the approach adopted by the Chief Justice in *Paciocco*, the legitimate scope of the comparison which is the subject of the assessment of extravagance or exorbitance involves an inquiry in terms of the obligee's interest in the due performance of the obligation. I accept that this is a potentially broad and qualitative inquiry and not a mechanical one.[88] Wilaci submits that its interest in the due performance of the obligation embraced all of the risks and concerns typical of the lender of AUD 37m to a dubious borrower on weak security. It says that those interests are brought into particular relief by the fact that it borrowed funds from Credit Suisse and was thus vulnerable to a whole array of

[88] *Paciocco v ANZ Banking Group Ltd* above n 8, at [187].

adverse developments if the loan changed from a short to a long term one. It says that its interest was to maintain the risk profile and the exposure which it had assessed for a 60 day loan at the time of entering into the contract and not to have that expand in an open ended way for an indeterminate period giving rise to consequent uncertainty and inability to manage risk.

[189] However, as the Chief Justice makes clear, in *Paciocco* the inquiry into interests legitimately protected by the bargain is "not … unconnected with recoverable damages".[89] Nor could it be because otherwise the prohibition on penalties would be illusory. Where, as here, valid reasons might be advanced for limiting the period for which the obligee was exposed to risk, it would amount to a charter for extravagant recovery.

[190] Moreover, this was a secured lending under a GSA giving rise to all the usual expansive range of remedies. The parties could not, in that context, have contemplated an indeterminate exposure. Although Wilaci allowed the loan to run on, that was its election. It could have declared an event of default and appointed receivers on expiration of the stipulated 60 day term.

[191] In a more finely balanced case I might be persuaded that Wilaci's interest in the due performance of the obligation was sufficient to avoid characterisation of the fee as extravagant. But I do not consider its claims in that category. There is such a disproportion between the contracted rate of recovery and what I regard as recoverable damages at common law that, whether the inquiry is in the terms identified by Allsop CJ in *Paciocco* or is into the purported "commercial justification" for the discrepancy, as some of the more recent English cases suggest,[90] the fee does not possess sufficient "compensatory character"[91] to save it.

[192] As indicated, the Judge under appeal in *Yarra* described the necessary correlation as being in the same "ball park". That may be more memorable than helpful given that a recovery almost twice the assessed loss (as was sanctioned in that case) may be considered by some beyond the limits of the definition but, where

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89 At [103].
90 *Elsley v J G Collins Insurance Agency*, above n 42.
91 *Multiplex Constructions Pty Ltd v Abgarus Pty Ltd*, above n 37, at 513.

as here, the sum sought to be recovered is many multiples of what I consider to be the recoverable damages, a finding of extravagance is inevitable.

[193] For the foregoing reasons I hold that the Late Payment fee was an unenforceable penalty.

Liability of limited partner

[194] Torchlight is not, as a result of an in specie distribution made in 2012, in a position to pay any debt found to be owing. In terms of s 16 of the Limited Partnerships Act the counterclaim defendant is therefore liable for all sums payable by Torchlight.

Claim for Credit Suisse cost of funds in addition to default interest

[195] Wilaci made a brief submission, unsupported by authority in support of the proposition that it should, in addition to interest at the contractually stipulated rate of 150 basis points over the Credit Suisse cost of borrowing, also be entitled to be reimbursed the cost of its borrowing. The amount involved was AUD 1,876,376. It says that such loss was foreseeable and not too remote.

[196] I am unable to accept Wilaci's submission. In my view it did not suffer the loss it alleges. Clause 3.5 provides that if Torchlight does not make payment on or before its due payment date, interest on the amount unpaid was to be paid at the Default Rate from the period of the due payment date until the actual date of payment. The Default Rate was defined in Schedule 1 to be at the same level as the "then current Interest Rate". The Interest Rate was set by adding a margin of 150 basis points to the Credit Suisse cost of funds on a pass through basis from Wilaci to Torchlight. In other words, the cost of the Credit Suisse loan was accounted for by the parties when they agreed their contractual terms.[92]

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[92] In his email of 24 August 2012 to Mr Jeston, Mr Grill stated that he was "expecting to recover all of my costs of going into the transaction which include legal, financial advice etc, loan set up costs (if any), *interest cost on the $37 million* (at approx 5.25 %) plus $5m providing loan is settled in 60 days…" (emphasis added). This confirms his understanding that the cost of funds was included in total recoveries.

[197] I doubt whether such a claim could in any event succeed. Every trading bank, to the knowledge of most borrowers, funds its lending from its own borrowings. I am unaware of any authority which would entitle a bank, in the event of default, to claim not only the interest rate stipulated in its loan documentation but its cost of funds.

Claim for receivers' costs and disbursements

[198] Wilaci seeks judgment for the costs incurred by its appointed receivers, McGrath Nicol and their Solicitors Minter Ellison Rudd Watts. It relies on cl 7 of the Loan Agreement in which Torchlight agreed to indemnify Wilaci for all costs, losses, expenses and liabilities sustained or incurred by Wilaci as a result of a default on the loan by Torchlight. The clause is in the following terms:

> **7 Indemnities**
>
> 7.1 The borrower will on demand indemnify and hold the Lender harmless against each cost, loss (including loss of profit or margin), expense (including all legal expenses on a solicitor and own client basis and taxes) and liability sustained or incurred by the Lender as a result of:
>
> (a) the occurrence or continuation of an Event of Default, or a Relevant Party not complying with any obligation expressed to be assumed by it in a Relevant Document; or
>
> (b) an amount payable by the Borrower to the Lender under a Relevant Document,
>
> (i) not being paid when due, whether by prepayment, acceleration or otherwise (but, so far as appropriate, credit is to be given for amounts, if any, of default interest paid under the Relevant Document) or,
>
> (ii) being paid or becoming payable otherwise than on a Payment Date (whether or not that payment is permitted or required under this Agreement); or
>
> (c) any repayment of the loan being made or becoming due except as expressly permitted by clauses 3.1 and 3.8 (even if the prepayment is required under this Agreement); or
>
> (d) the Facility not being drawn on the date requested,
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> by payment to the Lender of the amount the Lender certifies is required to indemnify it for that cost, loss, expense or other liability, including each cost and lost incurred in liquidating or re-employing deposits or other funds acquired or arranged to fund or maintain the Loan or any part of it.

> 7.2 The above indemnities are unconditional and irrevocable, are to survive termination of the Facility and payment of all other indebtedness due under any Relevant Document and are not to be discharged or impaired by an act, omission, matter or thing that might discharge or impair them but for this sub-clause.

[199] Relevant also is cl 11, particularly cl 11.2, in terms:

> 11.2 The Borrower will pay each cost and expense (including all legal expenses on a solicitor and own client basis and taxes) sustained or incurred by the Lender as a result of the exercise of, or in protecting or enforcing or otherwise in connection with, its rights under any Relevant Document or another transaction required or contemplated by any Relevant Document, in each case on demand and on a full indemnity basis.

[200] "Relevant Documents", is defined in cl 1.1 to mean "this Agreement, the Securities and each other agreement, present or future, required or contemplated by or relating to this Agreement or the Securities."

[201] The submissions of the parties in relation to whether receivers' costs (including legal disbursements) should be awarded were brief. Torchlight does not dispute that receivers' costs constitute costs, losses, expenses and or liabilities for the purposes of cl 7. However it makes two alternative submissions, namely that:

(i) the Court should assess receivers' costs in accordance with the principles of indemnity costs set out by the Court of Appeal in *Black v ASB Ltd*,[93] and that, pursuant to those principles, there is currently insufficient information before the Court to determine this issue.

(ii) the question of receivers' costs should be dealt with separately after the substantive judgment has been delivered, or alternatively, in proceedings relating to the Cayman Islands fund brought by the receivers and scheduled to be heard in 2016.

[202] Wilaci submits that the jurisdiction to review solicitor/client costs does not extend to receivers' costs or their legal disbursements. It submits that the receivers' costs are payable to it under the indemnity clause in the Loan Agreement and, as it is

93 *Black v ASB Ltd* [2012] NZCA 384.

not a party to the related proceedings, it is inappropriate to defer consideration of the issue in the manner suggested by Torchlight.

[203] I note that the parties have agreed that New Zealand law should apply to questions relating the construction of contracts. This leaves the following questions for determination:

(i) Whether cls 7 and 11 include receivers' costs;

(ii) If so, does this Court have jurisdiction to review these costs?

[204] I address these questions in turn.

Do clauses 7 and 11 include receivers' costs?

[205] In my view, a plain and ordinary reading of cls 7 and 11.2 includes the receivers' costs that are now sought by Wilaci. There is no dispute that the event of default occurred. Wilaci appointed receivers to protect its position as a creditor – in other words, Wilaci incurred the receivers' costs as a result of Torchlight's failure to comply with the obligations it assumed under the agreement.

[206] Accordingly, I find that cls 7 and 11.2 were triggered by the default on the Loan Agreement, and that Wilaci may rely on these clauses to claim a full indemnity for receivers' costs for which it is currently liable.

Does the Court have jurisdiction to review receivers' costs?

[207] Here I address Torchlight's submission that the Court should review the receivers' costs in accordance with the principles governing indemnity costs. For the reasons explained below, I do not consider that the Court has jurisdiction to conduct such a review.

[208] First, there is no general right of review or adjustment under the Loan Agreement. Clause 7.2 makes the agreed indemnities "unconditional and irrevocable" and provides that they are not to be discharged or impaired by any

thing. The jurisdiction to review receivers' costs can therefore only be based in statute or in the High Court Rules.

[209] Rule 14.6 of the High Court Rules governs indemnity costs. Pursuant to r 14.6(1)(b), indemnity costs are the actual costs and disbursements *reasonably incurred* by a party. In *Black v ASB Bank Ltd* the Court of Appeal said the following in respect of the requirement that indemnity costs be "reasonable":[94]

> It follows from the wording of r 14.6(1)(b) that indemnity costs are determined with reference to actual costs, but may be less than the actual costs if the Court considers the actual costs were not reasonably incurred.

[210] The Court then went on to analyse the proper approach to indemnity costs where solicitor/client costs are agreed to under a contract. The Court concluded that it should make an objective assessment of:[95]

> (a) what tasks attract a costs indemnity on a proper construction of the contract;
>
> (b) whether the tasks undertaken were those contemplated in the contract;
>
> (c) whether the steps undertaken were reasonably necessary in pursuance of those tasks;
>
> (d) whether the rate at which the steps were charged was reasonable having regard to the principles normally applicable to solicitor/client costs; and
>
> (e) whether any other principles drawn from the general law of contract would in whole or in part deny the claimant its prima facie right to judgment.

[211] Importantly, the reasonableness analysis is only applicable to costs to which pt 14 of the High Court Rules applies. Rule 14.1 provides that the Court has complete discretion in all matters relating to the costs of a proceeding, incidental to a proceeding, or of a step in the proceeding. As discussed above, receivers' costs in this case were incurred to better secure Wilaci's position as a creditor. They were not (or were not in any material sense) related to its counterclaim against Torchlight. It follows that receivers' costs are not part of the costs regime and accordingly, neither pt 14 of the Rules nor the 14.6(1)(b) requirement of reasonableness applies. For

[94] At [77].
[95] At [80].

these reasons, I do not consider there to be any jurisdiction to review receivers' costs under the High Court Rules.

[212] The only remaining avenue through which the Court has jurisdiction to review receivers' costs is an application made under s 34 of the Receiverships Act 1993, which provides:

> **34 Court supervision of receivers**
>
> (1) The court may, on the application of a receiver,—
>
> (a) give directions in relation to any matter arising in connection with the performance of the functions of the receiver:
>
> (b) revoke or vary any such directions.
>
> (2) The court may, on the application of a person referred to in subsection (3),—
>
> (a) in respect of any period, review or fix the remuneration of a receiver at a level which is reasonable in the circumstances:
>
> (b) to the extent that an amount retained by a receiver as remuneration is found by the court to be unreasonable in the circumstances, order the receiver to refund the amount:
>
> (c) declare whether or not a receiver was validly appointed in respect of any property or validly entered into possession or assumed control of any property.
>
> (3) Any of the following persons may apply to the court under subsection (2):
>
> (a) the receiver:
>
> (b) the grantor:
>
> (c) a creditor of the grantor:
>
> (d) a person claiming, through the grantor, an interest in the property in receivership:
>
> (e) the board of directors of the grantor or, in the case of a grantor that is in liquidation, the board of the grantor at the time the liquidator was appointed:
>
> (f) if the grantor is a company, a liquidator:
>
> (g) if the grantor is a person who has been adjudged bankrupt, the Official Assignee of the estate of the grantor.
>
> (4) The powers given by subsections (1) and (2)—

> (a) are in addition to any other powers the court may exercise under this Act, any other Act, or in its inherent jurisdiction; and
>
> (b) may be exercised in relation to a matter occurring either before or after the commencement of this Act and whether or not the receiver has ceased to act as receiver when the application is made.

…

[213] "Grantor" is defined in s 2 of the Act as "the person in respect of whose property a receiver is, or may be, appointed". "Creditor" includes "a person to whom the grantor owes a debt or is under a liability, whether present or future, certain or contingent, and whether an ascertained debt or a liability in damages".

[214] In *Eagle v Petterson* the defendant raised concerns about the allegedly inefficient way in which the receivers had obtained the company's records.[96] There was no cross-examination of the witnesses and very little evidence presented on the matter. Justice Heath proceeded on the basis that the receivers' evidence was accurate and their costs reasonable. His Honour concluded that if there were any questions about the amount of remuneration claimed by the receivers, it could be resolved by an application under s 34(2)(a), and if as a result of that review the Court considered that the amount paid to the receivers exceeded a reasonable amount, the Court could order the receivers to refund the difference under s 34(2)(b).

[215] In the present case there is no application before the Court to review receivers' costs under s 34(2)(a). Nor is there any evidence to suggest the costs claimed by the receivers are unreasonable having regard to the clearly extensive work undertaken by them in obtaining Torchlight's records and endeavouring to take control of the assets in receivership. I intend therefore to award receivers' costs now leaving open the possibility of a future application under s 34 and any associated refund.

[216] Without prejudging any such application, it seems to me that my finding in relation to the Late Payment fee does not of itself call into question the

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96 *Eagle v Petterson* HC Auckland CIV-2011-404-7387.

appropriateness of the receivers' appointment or the steps taken by them given that, independently of that fee, there was clearly a substantial amount owing in terms of interest and facility fees at the time the appointment was made. Moreover, it seems to me that Torchlight could have significantly reduced receivers' costs by reasonable co-operation with requests for information and/or acknowledgement of Wilaci's security over the assets indentified in the related proceedings, to the extent upheld in this claim.

[217] I make one final observation. Section 34 only gives the Court jurisdiction to review receivers' remuneration. It does not extend to disbursements. As was stated by Hoffmann J in *Re Potters Oils Ltd (No 2)*, dealing with an analogous UK provision, disbursements remain the subject of the law of agency,[97] and are potentially open to challenge in that context. In the present case, no such challenge has been made. Nor, as I have indicated, is there any evidence on which an assessment could proceed.

[218] As a result, I order Torchlight to pay Wilaci the costs and disbursements of the receivers.

Relief

[219] On the plaintiff's claim I:

(i) make a declaration that the Late Payment fee was a penalty and is therefore unenforceable.

(ii) order, pursuant to s 35(1)(a) of the Recieverships Act that, on payment of all amounts specified or declared payable pursuant to [220] and [221] of this judgment, and any such other sums as may be payable under the GSA, the first defendants must cease to act as receivers of the plaintiff and that the second defendant be prohibited from appointing any other receiver in respect of the property in receivership.

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97 *Re Potters Oils Ltd (No2)* [1986] 1 WLR 201 at 207, [1986] 1 All ER 890 at 895.

[220] On the counterclaim, I give judgment against the plaintiff and the counterclaim defendant for the following sums:

(i) The sum of AUD 5m being the fee described as payable in Schedule 1 cl (v)(a) of the Loan Agreement.

(ii) Interest on all outstanding sums in accordance with cl 3.5 of the Loan Agreement.

(iii) Receivers' costs and disbursements in the amount of $1,182,351.70 in accordance with the summary contained in paragraph 31 of the brief of evidence of Kare Johnstone.

[221] I make further orders:

(i) Declaring that the second defendant is, on the counterclaim, entitled to such additional receivers' costs as have been incurred since 31 July 2015; and

(ii) Reserving leave to all parties to refer any differences in calculation to the Court for its final determination (my expectation being that the parties' financial advisors can attend to quantification without further assistance from the Court).

Costs

[222] Wilaci seeks indemnity costs pursuant to the Loan Agreement. It is accepted that the jurisdiction to award such costs is subject to an assessment of reasonableness pursuant to r 14.6(1)(b).

[223] The parties are, in that context, agreed that the assessment of costs be deferred. Any such assessment (both in terms of proper incidence and quantum) will, in my view, need to take into account (in what is not intended to be an exhaustive list):

(i) Torchlight's success on the Late Payment fee issue.

(ii) Torchlight's late concession in respect of the fee provided for in Schedule 1(v)(a) of the Loan Agreement.

(iii) Torchlight's liability for interest in terms of Schedule 1 cl (v)(b) and under cl 3.5 of the Loan Agreement.

(iv) Wilaci's successful claim for receivers' costs and disbursements.

(v) The reasonableness assessment implicit in r 14.6(1)(b).

[224] In the event the parties are unable to settle costs, a telephone conference can be requested, timetable orders made for submissions and a hearing (if necessary) scheduled.

Muir J