NEW SOUTH WALES SUPREME COURT

CITATION:
Bay Bon Investments Selvarajah [2008] NSWSC 1251

JURISDICTION:
Equity

FILE NUMBER(S):
3800/07
14664/07

HEARING DATE(S):
9 May 2008

JUDGMENT DATE:
26 November 2008

PARTIES:
Bay Bon Investments Pty Ltd
v
Peter Rajakumaran Selvarajah & Anor;

Bay Bon Investments Pty Ltd
v
Peter Selvarajah

JUDGMENT OF:
White J

LOWER COURT JURISDICTION:
Not Applicable

LOWER COURT FILE NUMBER(S):
Not Applicable

LOWER COURT JUDICIAL OFFICER:
Not Applicable

COUNSEL:
Plaintiff: V Gray
Defendant: A Cheshire
3800/07:
2nd Defendant: D O'Dowd

SOLICITORS:
Plaintiff: David Milne & Associates:
Defendant: Goldrick Farrell Mullan Solicitors
3800/07
2nd Defendant: James Tuite & Associates

CATCHWORDS:
CONTRACTS – proof of terms – inference that debt remained unpaid to date of hearing – whether agreement to pay very high rates of interest as damages for late repayment unenforceable as a penalty

LEGISLATION CITED:
Conveyancing Act 1919 (NSW)
Duties Act 1997 (NSW)
Civil Procedure Act 2005 (NSW)

CATEGORY:
Principal judgment

CASES CITED:
Fitzgerald v Masters (1956) 95 CLR 420
Axon v Axon (1937) 59 CLR 395
Wright v Morton [1998] 3 VR 316
Jackson v Irvin (1809) 2 Camp 48; 170 ER 1077
Acron Pacific Ltd v Offshore Oil NL (1985) 157 CLR 514
Hungerfords v Walker (1989) 171 CLR 125
David Securities Pty Ltd v Commonwealth Bank of Australia (1990) 23 FCR 1
Ringrow Pty Ltd v BP Australia Pty Ltd [2005] HCA 71; (2005) 224 CLR 656
AMEV–UDC Finance Ltd v Austin (1986) 162 CLR 170
Parker v Paton (1941) 41 SR (NSW) 237
Hampton Court Ltd v Crooks (1957) 97 CLR 367
Apollo Shower Screens Pty Ltd v Building and Construction Industry Long Service Payments Corporation (1985) 1 NSWLR 561
Krstic v Brindley [2006] NSWSC 1414
Accom Finance Pty Ltd v Mars Pty Ltd [2007] NSWSC 726; (2007) 13 BPR 24,729

TEXTS CITED:

DECISION:
Refer to paragraphs 58-61 of judgment.

JUDGMENT:

IN THE SUPREME COURT
OF NEW SOUTH WALES
EQUITY DIVISION

WHITE J

Wednesday, 26 November 2008

3800/07 Bay Bon Investments Pty Ltd v Peter Rajakumaran Selvarajah & Anor
14664/07 Bay Bon Investments Pty Ltd v Peter Selvarajah

JUDGMENT

1 **HIS HONOUR**: These proceedings were heard together. In proceeding 14664/07, the plaintiff, Bay Bon Investments Pty Ltd, alleged that the defendant, Mr Selvarajah, had guaranteed the repayment of two loans made by the plaintiff. The first loan was made on 22 December 2006 to Radiology Developments Pty Ltd. The principal amount of the loan was $300,000. The loan was for a period of one month expiring on 22 January 2007 and carried interest of five percent, being $15,000 which was prepaid. The loan was secured by the grant of second mortgages by Radiology Developments (Melbourne No. 1) Pty Ltd and Radiology Developments Pty Ltd of land owned by those companies in Victoria.

2 The defendant denies having guaranteed the loan.

3 The plaintiff alleges that at the request of the mortgagors the loan was extended to 22 February 2007. This is denied. There is no evidence of such an extension.

4 On or about 7 February 2007, the plaintiff made a further loan of $300,000 to Radiology Developments (Melbourne No. 1) Pty Ltd and Radiology Developments Pty Ltd.

5 The plaintiff alleged that the terms of this loan were that:

(a) the loan was for a term of one month expiring on 7 March 2007;

(b) the loan was of a principal sum of $300,000;

(c) it was at a lower rate of interest of 8.35 percent per annum;

(d) it was at a higher rate of interest of 15 percent per annum;

(e) interest was to be simple interest and prepaid for the term of $25,000;

(f) damages for late payment would accrue at the higher rate of interest as well as an additional sum equal to one month's interest for every month or part of a month the loan is overdue.

6 The defendant admitted this allegation and pleaded that the term described in (f) above was a penalty. The documents tendered by the plaintiff at the hearing in relation to this loan showed that the relevant rates of interest were 8.35 percent per month and 15 percent per month, rather than per year.

7 The plaintiff did not seek to amend, but the statement of claim contains an obvious error. No point was taken by the defendant that because of the pleadings, the plaintiff was only entitled at best to recover the principal, plus interest at 15 percent per annum, plus damages. Had such a point been taken I would have granted the plaintiff leave to amend.

8 According to the plaintiff, the first loan attracts interest of $30,000 per month and in addition the defendant is liable to pay a further $30,000 per month by way of damages for each month or part thereof that the debt remains outstanding. In the case of the second loan of $300,000, the plaintiff contends that it attracts interest of $45,000 per month and in addition, the defendant is liable to pay damages of $45,000 per month for each month or part thereof that the loan is outstanding.

9 The plaintiff alleges that Mr Selvarajah agreed to give an equitable mortgage or charge to the plaintiff to secure his liability as guarantor over land of which he is a co-owner. In proceeding 3800/07 the plaintiff seeks an order for the appointment of trustees for sale of Mr Selvarajah's interest in the land pursuant to ss 66F and 66G of the *Conveyancing Act* 1919 (NSW). If it is found that Mr Selvarajah is liable for any amount as guarantor, and if it is also found that he has given a charge or mortgage over the land to the plaintiff, there is no issue as to the plaintiff's entitlement to an order for the appointment of trustees for sale.

10 The evidence was sparse. The defendants called no evidence. There was no admission on the pleadings that Mr Selvarajah had given a guarantee or that he was liable for all or any part of the debt alleged by the plaintiff.

11 The issues are:

1. whether any contract of guarantee or charge came into existence in the absence of proof that the documents relied on by the plaintiff were executed by it;

2. what terms of a guarantee or charge, if any, were incorporated by reference in documents signed by Mr Selvarajah;

3. if the documents relied on by the plaintiff contain the relevant contractual terms, whether Mr Selvarajah gave a charge over his assets to secure his liability as guarantor;

4. if so, whether the charge is enforceable, as the document was not stamped;

5. whether the plaintiff proved that there was any outstanding indebtedness; and

6. whether the provisions for payment of interest at a higher rate or for payment of damages for late repayment are invalid as penalties.

The Contractual Documents

12 Two sets of documents were brought into existence in respect of each loan. For each loan Radiology Developments Pty Ltd and Radiology Developments (Melbourne No. 1) Pty Ltd executed a mortgage and were named as borrower. The documents were not executed under seal but were signed by Mr Selvarajah as sole director and secretary. No issue was taken as to the method of signing. Mr Selvarajah also signed documents as guarantor in respect of each of the loans to each borrower. The plaintiff read an affidavit of its director, Mr

Langley. He produced a folder of documents which was marked as exhibit PCL1. Some of the pages to the exhibit were illegible. The plaintiff then tendered what were said to be the originals of four mortgages and associated documents including guarantees.

13 In respect of the first loan, Mr Langley deposed that on 22 December 2006, Radiology Developments Pty Ltd and Mr Selvarajah executed:

> "*(i) the mortgage at page 1 ('Mortgage A');*
>
> *(ii) the authority and direction at page 31;*
>
> *(iii) the declaration by Third Party Mortgagor, Guarantor, Surety, Mortgagor or Indemnifier for Borrower at page 32;*
>
> *(iv) the provision of credit-purpose declaration at page 33*",

and delivered those documents to the plaintiff. He deposed that Radiology Developments (Melbourne No. 1) Pty Ltd and Mr Selvarajah executed:

> "*(i) the mortgage at page 34 ('Mortgage B');*
>
> *(ii) the authority and direction at page 64;*
>
> *(iii) the declaration by Third Party Mortgagor, Guarantor, Surety, Mortgagor or Indemnifier for Borrower at page 65;*
>
> *(iv) the provision of credit-purpose declaration at page 66*".

He gave similar evidence in relation to two mortgages and associated documents executed on 7 February 2007 with respect to the second loan.

14 This evidence was read without objection. The mortgage at page 1 was signed by Mr Selvarajah on pages 2 and 3. The mortgagor was Radiology Developments Pty Ltd and the mortgage secured a principal sum of $300,000. It referred to an annexure "A" which was signed by Mr Selvarajah on behalf of Radiology Developments Pty Ltd and by himself as guarantor. The annexure included the following details:

(a)	Date	22nd Day of December 2006
(b)	Term	1 Month
(c)	Expiry Date	22nd Day of January 2007
(d)	Principal	$300,000.00
(e)	Lower rate	5%
(f)	Higher rate	10%
(g)	Interest type	Simple interest, to be pre-paid for the Term ($15,000).
(i)	First Instalment due	22nd Day of December 2006
(j)	Address for service	72 Island Parade Banksia Beach Bribie Island QLD 4507
(m)	Borrower(s)	Radiology Developments Pty Limited ACN 121 190 485 of 4 Traminer Grove Orchard Hills NSW 2748
(n)	Guarantor(s)	Peter Selvarajah of 4 Traminer Grove Orchard Hills NSW 2748
(o)	Damages for late repayment	In the event the mortgagor repays the loan late the

mortgagor will have to pay the higher rate of interest from the expiry date onwards as well as an additional sum equal to one month's interest for every month or part of a month that the loan is overdue.

15 The first page of the mortgage included a term that "*the provisions contained in Memorandum of Common Provisions retained by the Registrar of Titles in Number are incorporated in this mortgage.*" No Memorandum of Common Provisions was specified.

16 Included at pages 4-30 of the exhibit were sometimes illegible terms. They were divided into sections, namely, "Definition of Terms", "Rules of Interpretation", "Common Provisions", "Mortgage Provisions", "Loan Provisions", "Guarantee Provisions" and "Charge Provisions". None of the pages was initialled by Mr Selvarajah or anybody else. There is no evidence that they were provided to Mr Selvarajah at the time he signed the documents. Nor is there anything to connect those pages with the unnumbered "Memorandum of Common Provisions" referred to on the first page of the mortgage. In the section called "Definition of Terms" there was included a clause 15 which provides:

> "*15. The following words, when used in the memorandum, have the values listed in the SCHEDULE:*
>
> *(a) DATE*
>
> *(b) TERM*
>
> *(c) EXPIRY DATE*
>
> *(d) PRINCIPAL*
>
> *(e) LOWER RATE*
>
> *(f) HIGHER RATE*
>
> *(g) INTEREST TYPE*
>
> *(h) INSTALMENTS DUE*
>
> *(i) INTEREST PAYABLE*
>
> *(j) FIRST INSTALMENT DUE*
>
> *(k) COLLATERAL MORTGAGE*
>
> *(l) ADDRESS FOR SERVICE*
>
> *(m) BORROWER*
>
> *(n) GUARANTOR*

(o) *CHARGOR*

(p) *DAMAGES FOR LATE REPAYMENT*

(q) *DAMAGES FOR EARLY REPAYMENT*

(r) *SPECIAL CONDITIONS*"

17 Clause 1 of the Definition of Terms provided:

"*SCHEDULE means the annexure/s to the mortgage which refers to this memorandum.*"

18 It may be observed that the table which is part of the annexure commences by following the pattern of clause 15 in that the items lettered (a), (b), (c), (d), (e), (f), and (g) all refer to the same terms as appear in clause 15 against the same lettered paragraphs. However, there is no correspondence between clause 15 and the paragraphs in the table lettered (i), (j), (m), (n) and (o).

19 It will be observed that the table in the mortgage does not specify a "Chargor".

20 The only other document signed by Mr Selvarajah included in exhibit PCL1 which might pick up the pages tendered as containing the detailed terms was a document entitled "Declaration by Third Party Mortgagor, Guarantor, Surety, Mortgagor or Indemnifier for the Borrower". Mr Selvarajah declared that:

"*After receiving [independent legal] advice I have freely and voluntarily signed the following documents (Specify the documents produced for signature)*

(a) *Mortgage and Mortgage Memorandum incorporating the mortgage provisions, loan provisions, guarantee provisions and charge provisions*
(b) *Authority and Direction*."

21 However, there is no evidence that the documents incorporated in the exhibit as the mortgage provisions, loan provisions, guarantee provisions and charge provisions were the documents incorporated by reference in the mortgage and mortgage memorandum. There was no evidence that they were the "Memorandum of Common Provisions retained by the Registrar of Titles".

22 Mr Selvarajah signed an authority and a direction to the plaintiff in his capacity as sole secretary and director of Radiology Developments Pty Ltd and separately as guarantor. The document stated:

"*We are authorised and directed as follows:*

1. ***Complete and date***

To complete and date the mortgage(s), guarantee(s) and/or any other documents in respect of any matter in which they may be incomplete and we undertake to immediately attend to any requisition that may be made by any authority in relation to them.

2. ***To Pay***

To pay the amount of the initial advance to Radiology developments (Melbourne No 1) Pty Limited as they direct."

23 In the light of clause 2 of this document, it should be read as if it said that "*You are authorised and directed*" not that "*We are authorised and directed*". Thus the plaintiff was authorised to complete any documents in respect of a matter which might be incomplete. That does not mean that the plaintiff could incorporate any terms of its choosing as the terms of the loan, mortgage, guarantee, or charge. The contrary was not suggested.

24 The plaintiff then tendered what it initially asserted were the originals of the documents in exhibit PCL1. It did so after I complained that some of the photocopies which made up that exhibit were illegible. The documents tendered included the original pages bearing Mr Selvarajah's signatures, the various detailed terms included in exhibit PCL1, together with some further pages to which I refer below. The documents were not attached in any permanent way. They were clipped together with a bulldog clip. Some pages showed evidence of having been stapled; others not. Better photocopies of the detailed terms included in exhibit PCL1 were included in the documents tendered as the originals. Amongst the documents tendered was a document called "Mortgage Memorandum" which was signed by Mr Selvarajah on behalf of Radiology Developments Pty Ltd and on his own behalf. It stated:

"*Filed in the NSW Land and Property Information*

This memorandum incorporates the following:

1. Mortgage
2. Loan
3. Guarantee
4. Charge."

25 Another document was headed "Declaration by the Borrower". In it Mr Selvarajah, on behalf of Radiology Developments Pty Ltd, declared (again) that he had freely and voluntarily signed: a Mortgage over the property, the Mortgage Memorandum incorporated the mortgage provisions, loan provisions, guarantee provisions and charge provisions, and the Authority and Direction. There is nothing in these further documents that establishes that the detailed terms which were included in the tender are the documents described as having been incorporated in the mortgage. The documents have not been initialled or otherwise identified by any party. There is no evidence that they were provided to Mr Selvarajah, or even that they were the standard terms used by the plaintiff at the time of the transactions. As previously noted, there is a disconformity between the table which forms part of the annexure to the mortgage and clause 15 in the definition of terms.

26 The position is the same in relation to each of the other three sets of documentation. As previously noted, separate mortgages were given in respect of each loan by Radiology Developments Pty Ltd and Radiology Developments (Melbourne No. 1) Pty Ltd. In respect of each loan both companies were described as the borrowers. Mr Selvarajah signed each of the documents as guarantor. In none of the other sets of documentation is it established that the detailed terms described at [16] above, which the plaintiff tendered, were incorporated as terms of a contract entered into by Mr Selvarajah. On none of the documents Mr Selvarajah signed was he described as a chargor or a mortgagor.

27 The schedules contained in the annexure to each mortgage securing the second loan made on 7 February 2007 provided as follows:

(a)	Date	7th Day of February 2007
(b)	Term	1 Month
(c)	Expiry Date	7th Day of March 2007

(d)	Principal	$300,000.00
(e)	Lower rate	8.35% per month
(f)	Higher rate	15% per month
(g)	Interest type	Simple interest, to be pre-paid for the Term ($25,000).
(i)	First Instalment due	Day of December 2006 [sic]
(j)	Address for service	4 Traminer Grove Orchard Hills 2748
(m)	Borrower(s)	Radiology Developments Pty Limited ACN 121 190 485 of 4 Traminer Grove Orchard Hills NSW 2748
(n)	Guarantor(s)	Peter Selvarajah of 4 Traminer Grove Orchard Hills NSW 2748
(o)	Damages for late repayment	In the event the mortgagor repays the loan late the mortgagor will have to pay the higher rate of interest from the expiry date onwards as well as an additional sum equal to one month's interest for every month or part of a month that the loan is overdue.

Each of the schedules in the annexures to the mortgages from the second loan was signed by the solicitor for the lender.

28 As noted above, Mr Cheshire of counsel, who appeared for Mr Selvarajah, submitted that there was no binding contract of guarantee because the documents relied on as containing the contract had not been signed by the lender. This argument is only available in respect of the first loan. I do not accept it. The evidence is that on the same day the documents executed by the two borrowing companies and by Mr Selvarajah as guarantor were delivered to the plaintiff, it transferred the loan amounts to the borrowing companies. It is clear that the plaintiff made the loans on the basis of the documents signed by the borrowing companies and by Mr Selvarajah as guarantor. In terms of offer and acceptance, the plaintiff accepted Mr Selvarajah's offer to guarantee the loans by making the loans.

29 Mr Cheshire also submitted that the plaintiff's claim failed at the outset because it failed to prove the terms of the contract. The plaintiff asserted that the terms were contained in the detailed provisions it tendered, but failed to prove that those provisions were incorporated as contractual terms.

30 For the reasons above, I accept that the plaintiff failed to prove the detailed provisions in the documents it tendered were incorporated as the terms of the contract. It does not follow that the plaintiff's case fails *in limine*. The documents signed by Mr Selvarajah expressly names him as a guarantor. The terms as signed by him and set out at paras [14] and [27] are sufficiently certain to give rise to a contract of guarantee, even in the absence of the more detailed provisions which were contemplated by the documents he signed. Mr Cheshire submitted that the contract could not be construed as a simple contract of guarantee because it was clear from the reference to provisions of other documents that other terms were intended to be incorporated. He submitted that unless the plaintiff could prove what were the terms of the guarantee incorporated by reference, it failed to prove what the terms of the guarantee were.

31 The underlying assumption in this submission is that the parties did incorporate other terms as was envisaged. If other terms were so incorporated, it would be open to the plaintiff or the defendant to prove what they were. In the absence of such proof, I infer that although the documents contemplated that other terms would be incorporated, the parties failed to incorporate such other terms. That does not mean that no contract was entered into. It simply means that the terms of the contract are to be found on the pages signed by the borrowers and Mr Selvarajah.

32 It follows that there is no question of Mr Selvarajah having given a charge over any of his property.

33 Even if the terms alleged by the plaintiff had been incorporated into the contract, the "Charge Provisions" would not have applied. The relevant clause was clause 160 which provided that:

> "*THE CHARGOR, as beneficial owner, charges the ASSETS as security to the LENDER for the payment of the DEBT and the performance by the CHARGOR of all of its obligations under this CHARGE.*"

34 Clause 15 provided that the word "CHARGOR" had the "Values listed in the Schedule". As no-one was named in the schedule as CHARGOR, the Charge Provisions were not attracted. Mr Selvarajah was named as "GUARANTOR". The plaintiff relied upon clauses 4 and 5 of the Definition of Terms. They provided:

> "*4. GUARANTEE means the agreement constituted by that part of this memorandum headed 'Charge Provisions' read together with the SCHEDULE.*
>
> *5. CHARGE means the agreement constituted by that part of this memorandum headed 'Guarantee Provisions' read together with the SCHEDULE.*"

35 It was submitted for the plaintiff that the effect of clause 4 was that because Mr Selvarajah was named as guarantor, the guarantee he gave was the agreement constituted by the part of the document under the heading "Charge Provisions". It was submitted that, although not named as chargor because he gave a "guarantee" meaning the agreement constituted by the "Charge Provisions", he was also taken to have charged his assets under clause 160. It was also submitted for the plaintiff that, as Mr Selvarajah was named as a guarantor, he was also bound by clauses 148 and 148 of the "Guarantee Provisions" whereby the "guarantor" guaranteed the due and punctual performance of the obligations of the "debtors".

36 If it were necessary to decide this question, I would not accept the submission. I think there is a plain mistake in clauses 4 and 5 which can be corrected to avoid absurdity without the need for rectification (*Fitzgerald v Masters* (1956) 95 CLR 420 at 426-427). Even if that were not so, the fact remains that Mr Selvarajah was not a chargor as defined and therefore clause 160 would not apply to him.

37 This is further confirmed by clause 28 which provides:

> "*In the event that the item CHARGOR in the SCHEDULE names more than one company then all companies will be deemed to have executed separate charges. In the event a company is named as MORTGAGOR, BORROWER or GUARANTOR it will be deemed to be named as a CHARGOR.*"

38 The fact that corporate guarantors were deemed to be named as chargors shows that, in the absence of such a deeming provision, a person named as guarantor was not to be taken to be a chargor. There was no equivalent provision in respect of individual guarantors.

39 No reliance was placed on clauses 68 or 69 which contained agreements for the mortgaging of land. As I have concluded that the detailed provisions were not incorporated as terms of the contract, it is unnecessary to consider that matter any further.

40 It is also unnecessary to consider the consequence of the documents not having been stamped as a charge (*Duties Act* 1997 (NSW) ss 211 and 304).

41 It follows that the plaintiff's claim in proceeding 3800/07 for the appointment for trustees for sale will be dismissed.

42 Mr Cheshire submitted that the plaintiff's claim on the guarantee should be dismissed because it had failed to prove that at the date of hearing, any moneys remained unpaid by the borrowers. The plaintiff read Mr Langley's affidavit of 19 November 2007 in which he deposed that neither of the borrowers had repaid the moneys lent or any part thereof. He asserted that as at 7 December 2007, the borrowers and Mr Selvarajah would be indebted to the plaintiff in the sum of $2,160,000, with interest continuing to accrue at ten percent per month in the case of the first loan, and 15 percent per month in the case of the second loan on the principal sums advanced of $300,000 and $330,000 respectively, together with damages for late payment at ten percent per month in the case of the first loan and 15 percent per month in the case of the second loan.

43 There was no evidence as to whether the loans had been reduced or discharged after 19 November 2007. Mr Cheshire submitted that it would have been a simple matter for the plaintiff to have deposed whether any repayment had been made, and if so, in what amount; and that having failed to do so, the plaintiff had not proved that anything was owing, or if so, what sum was owing. Mr Gray who appeared for the plaintiffs, submitted that in the absence of evidence to the contrary, it should be presumed that the debt which was unpaid as at 19 November 2007 remained unpaid. It would have been open to Mr Selvarajah, who signed the documents as sole director and secretary of the borrowers, to have adduced evidence of any repayment.

44 The so-called presumption of continuance is simply an inference that can be drawn in some cases from the fact that a state of affairs existed at one point of time, that the same state of affairs existed at an earlier or later point of time. Whether the inference should be drawn depends on the particular circumstances and the chance or likelihood of intervening circumstances having altered that state of affairs (*Axon v Axon* (1937) 59 CLR 395 at 404-405; *Wright v Morton* [1998] 3 VR 316 at 332-336). In *Jackson v Irvin* (1809) 2 Camp 48; 170 ER 1077, the inference was drawn in respect of a debt of a bankrupt proved to have existed some months before the act of bankruptcy, where there was no evidence as to whether it continued down to the time of bankruptcy. The report states that Lord Ellenborough held (at 50) that "*the debt being proved to have once existed, its continuance would be presumed.*"

45 The fact that the so-called presumption of continuance was applied in one case concerning the existence of a debt does not mean that it applies in all cases. That follows from the fact that it is not a true presumption, but rather a description of a process of reasoning by which inferences of fact might properly be drawn. In the present case, one can draw the inference from the fact that the loans were made at very high rates of interest and that the borrowers and the guarantor were unable (as distinct from unwilling) to repay the debts when they fell due on 22 January 2007 and 7 March 2007. It can be inferred that they remained unable to repay any part of the debt up to at least 19 November 2007. If that were not so, one would expect repayments to have been made to avoid the crippling rates of interest claimed by the plaintiff. In the absence of evidence to the contrary, I infer that that inability continued and the debts remained unpaid to the date of hearing.

46 The next question is what, on the proper construction of the contract, is payable. Each loan expired one month after it was made. One month's interest at the lower rate of five percent per month in the case of the first loan and 8.35 percent in the case of the second loan was prepaid. The contracts expressly provide for the payment of damages if the loans are not repaid at the end of the term. There are two components of the damages. One is the payment of the higher rate of interest from the expiry date until repayment (that is, at the rate of ten percent per month for the first loan and 15 percent per month for the second loan). In addition, for each month or part of a month that the loan was overdue a further "one month's interest" is payable. In the context in which the words "one month's interest" appear, it is an additional one month's interest at the higher rate. The contrary was not contended. Accordingly, the damages can be calculated as a minimum of 20 percent per month (or 240 percent per annum) in the case of the first loan, and 30 percent per month (or 360 percent per annum) in the case of the second loan.

47 The agreement to pay interest as damages for late repayment attracts the doctrine of penalties if, as a matter of substance, the sum payable is not a genuine pre-estimate of the loss the plaintiff may suffer by being kept out of its money, but is in the nature of a punishment (*Acron Pacific Ltd v Offshore Oil NL* (1985) 157 CLR 514 per Deane J at 520). The moneys are payable as a consequence of a breach of contract rather than as

the withdrawal of an incentive. This distinguishes this case from those where a mortgage stipulates a higher rate of interest reduceable to a lower rate if instalments are paid on time.

48 It is no longer the law that damages cannot be recovered for late payment of a debt (*Hungerfords v Walker* (1989) 171 CLR 125). In any event, a provision for the payment of interest at a higher rate after default which does not operate retrospectively is not a penalty provided it can be seen as a genuine pre-estimate of compensation for loss the lender would suffer by being kept out of its money (*David Securities Pty Ltd v Commonwealth Bank of Australia* (1990) 23 FCR 1 at 30, 31).

49 In *Ringrow Pty Ltd v BP Australia Pty Ltd* [2005] HCA 71; (2005) 224 CLR 656, the High Court referred with approval to a statement by Mason and Wilson JJ in *AMEV–UDC Finance Ltd v Austin* (1986) 162 CLR 170 at 190 that an agreement to pay a sum as damages should only be struck down as a penalty if "*it is out of all proportion to damage likely to be suffered as a result of breach*" (at 667 [27]). In *Ringrow Pty Ltd v BP Australia Pty Ltd* the High Court said (at 669 [32]):

> "*Exceptions from that freedom of contract require good reason to attract judicial intervention to set aside the bargains upon which parties of full capacity have agreed. That is why the law on penalties is, and is expressed to be, an exception from the general rule. It is why it is expressed in exceptional language. It explains why the propounded penalty must be judged* 'extravagant and unconscionable in amount'. *It is not enough that it should be lacking in proportion. It must be* 'out of all proportion'".

50 There was no evidence, except that which can be inferred from the loans made to the two borrowing companies, of the extent of the likely or possible loss to the plaintiff from its loans not being repaid on the due dates. It goes without saying that the borrowers and guarantor remain liable to repay the principal debt, and that the damages for which the agreements provide are in addition to the obligation to repay principal. It was submitted for the plaintiff that the onus was on the defendant to show that the sum payable as agreed damages was out of all proportion to any loss that the plaintiff could have suffered and that the defendant led no evidence to support that contention.

51 Whilst I accept that the onus is on the defendant to show that the provision is a penalty, it appears to me that once some evidence is adduced which may be sufficient to satisfy that onus, there is an evidentiary onus on the plaintiff to explain the nature of its business, the rates at which it is able to lend, and how, when the contracts were entered into, it would have been anticipated that the moneys would be re-deployed on repayment of the loans. This information was entirely in the plaintiff's camp. Evidence is to be weighed according to the power of a party to produce it. Where facts are peculiar within the knowledge of one party, comparatively slight evidence may be sufficient to discharge the onus of proof lying on the opposite party (*Parker v Paton* (1941) 41 SR (NSW) 237 at 243; *Hampton Court Ltd v Crooks* (1957) 97 CLR 367 at 371-372; *Apollo Shower Screens Pty Ltd v Building and Construction Industry Long Service Payments Corporation* (1985) 1 NSWLR 561 at 564-65; *Krstic v Brindley* [2006] NSWSC 1414 at [26])

52 Part of the inquiry is whether "*the propounded penalty [is] 'extravagant and unconscionable in amount*'". No evidence was led as to the value of the mortgage security taken by the plaintiff over the land of the two borrowing companies. As it can be inferred that the borrowers have not repaid any part of the loans, it can also be inferred that the plaintiff has not considered it worthwhile to exercise its power of sale over the mortgaged properties, assuming that right exists. There is no evidence as to the value of Mr Selvarajah's guarantee. The fact that the loans were for short terms and at very high rates of interest (five percent and 8.35 percent per month) indicates that the transaction was, as Mr Gray submitted, "*outside the normal parameters of a commercial lending environment*."

53 In *Accom Finance Pty Ltd v Mars Pty Ltd* [2007] NSWSC 726; (2007) 13 BPR 24,729, Windeyer J dealt with the challenges made to certain mortgages and guarantees which secured loans with lower interest rates of 48 percent and 60 percent and higher interest rates of 96 percent and 120 percent. His Honour said (at [54]-[55]):

"*[54] The final issue to address is whether Accom's interest rates somehow made the transaction unconscionable. Many people would think that the rates of interest charged were exorbitant for first mortgage loans of say 75% of value. I agree. But bad bargains are not necessarily unconscionable bargains or illustrative of unconscionable conduct. The fact is that there have been quite a number of decisions in this Court of trial judges where interest rates similar to the ones here have been upheld or at least not resulted in any relief being given on that ground: eg* Takemura v National Australia Bank Ltd *[2003] NSWSC 339;* Guardian Mortgages v Miller *[2004] NSWSC 1236;* King Investment Solutions v Hussain *[2005] NSWSC 1076. Accom's rates, or at least the higher rates, have nothing whatsoever to do with risk, although it is possible the lower rates might have some connection in view of the speed with which the loans are made available. The higher rates really have everything to do with what the lender thinks can be got away with, which at least here seems to be a doubling of the lower rate. However, unless there is pure asset lending, the fact that the rates appear exorbitant does not in itself make them unconscionable. I am aware through experience in other cases that such rates are not unusual. It is not claimed by para 22(c)(i) of the cross-claim that the rate is unconscionable; what is claimed is that Accom arbitrarily fixed a grossly excessive rate and that Mars had no capacity to negotiate the rate. ...*

[55] There was no argument that the higher rate and the provision for a special payment on default was a penalty, probably because in the long run there was no claim for a money judgment as against Kowalczuk. In any event, at least so far as the higher rate is concerned, I agree with what Campbell J said in King Investment Solutions Pty Ltd v Hussain *at paras 136 and 137, that while it may be time for substance to prevail over form a trial judge can do nothing but follow the established law. ... Although I consider I am bound to follow the long established law on higher and lower interest rates, my reason for thinking it is time for a change is because the principle is based upon the understanding that the higher rate is a proper rate and the lower rate a concessional rate. Such reasoning envisages a relatively small variation between the rates. No one could consider 120% a proper rate even if 48% or even 60% could be justified as a proper rate. Thus when attention is given to the lower rate alone the principle really becomes absurd."*

54 The significance of this for present purposes is not his Honour's reference to the law that where there is a promise to pay a very high interest rate with a concessional lower rate if payments are made on time, the promise to pay the higher rate cannot be challenged as a penalty. Rather its significance for present purposes is that it demonstrates, as the transactions in this case demonstrate, that there is a market for loans of last resort at very high interest rates. However, there comes a point (as his Honour observed at [55]), where a rate is so high that it cannot be considered proper. That point is reached where the rate operates *in terrorem* and as a punishment for default rather than as compensation to the lender for being kept out of its money.

55 In the case of the first loan, the mortgagor/borrower, and hence the guarantor, is liable in the event of default to pay as damages interest of at least four times the rate charged on the loan, which was itself 60 percent per annum. In the case of the second loan, the rate of interest per annum (payable as damages) is increased from 100.2 percent to at least 360 percent. Whilst I can accept that there is a market in which the plaintiff may have been able to re-deploy its money at very high rates of interest of 60 percent or 100 percent or even 120 percent per annum, in the absence of evidence from the plaintiff, I would not conclude there was a market in which it could lend at rates of 240 percent or 360 percent per annum. Still less would I conclude in the absence of evidence from the plaintiff that had the loans been repaid, the moneys could have been used to reduce or discharge liabilities of the plaintiff which incurred interest at those rates.

56 In my view, the disparity between the interest rates charged for the term of the loans and the interest payable as damages for late repayment is so great that the proper conclusion is that the provision for payment of damages is not a genuine pre-estimate of damage, but the imposition of a different financial obligation in the

nature of a punishment. The disparity is so great that it is out of all proportion to the damage which it can be inferred the plaintiff could suffer as the result of the borrowers' failure to repay the loan and the guarantor's default. I conclude that those provisions are void as penalties.

57 It follows that there will be judgment for the plaintiff against Mr Selvarajah for the unpaid amounts of the principal of the two loans totalling $600,000, together with interest at the prescribed rates from 22 January 2007 and 7 March 2007.

58 For these reasons, I make the following orders:

1. In proceeding 14664/07, give judgment for the plaintiff against the defendant in the sum of $600,000 together with interest pursuant to s 100 of the *Civil Procedure Act* 2005 (NSW) at the rates prescribed in Sch 5 to the Uniform Civil Procedure Rules on the sum of $300,000 from 22 January 2007 and on the sum of $300,000 from 7 March 2007.

2. In proceeding 3800/07, order that the summons be dismissed.

59 My preliminary view is that, although the plaintiff was unsuccessful on the issue of penalty, it is entitled to its costs of proceeding 14664/07 and that the defendants are entitled to their costs of proceeding 3800/07.

60 However, if any party seeks a different order, I will hear submissions on costs.

61 Exhibits may be returned after 28 days.

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LAST UPDATED:
27 November 2008