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June 2010 Newsletter

>> WHAT IS ASSET LENDING?**When is Asset Lending Unfair...?**

The Courts in New South Wales have looked at lending that relies on the assets of the borrower with little regard as to how the loan would be repaid. This type of lending has come to be known as asset lending. The Courts have said that in certain circumstances, such an agreement could amount to an unjust contract. In *Perpetual Trustee Co Ltd v Khoshaba*, the Court said that to lend money without any regard to the ability of the borrower to repay by instalments under the contract knowing that adequate security is available if there is a default, is to engage in a potentially fruitless enterprise simply because there is no risk of loss. If the security is the sole residence of the borrower, the Court held that there is a public interest in treating such contracts as unjust at least when the borrowers can be said to have demonstrated an inability reasonably to protect their own interests.

In the cases of *Khoshaba* and *Elkofairi*, the contracts were held to be unjust.

In the case of *Harvgraves Secured Investments Limited v Waller*, Mrs Waller argued that one of her loans was unjust in this way. The Court held that Mrs Waller had made a deliberate decision to proceed knowing the possible consequences and held that the contract was not unjust.

Pure asset lending is not illegal and there may be circumstances in which it is not unfair but the Courts will look at the circumstances of any particular case and make a decision about whether or not a particular contract is unjust and should be set aside.

>> HIGH INTEREST RATES**In Recent Times Lenders of Short Term Money Have Been Asking Borrowers to pay High Interest Rates...**

There Has Been Discussion About Whether or Not Such High Interest Rates Amount to a Penalty and Therefore Cannot be Recovered...

In the recent decision of *Kowalczyk*, the Court discussed the interest rates on two short term loans. The difference between the normal rate and the default rate in one loan was forty eight percent and in the second loan, sixty percent.



The Judge first discussed the law of penalties. He pointed out that a contract provision that imposed an extra obligation when there was a default, was unjust if the extra obligation imposed was not a genuine attempt to estimate the loss that flowed as a consequence of the default.

The Judge considered that differences of forty eight percent and sixty percent in the mortgages in the matter before him. He said that the difference was not anything like a genuine attempt to estimate loss that might occur if there was a default. He was of the opinion that these high interest rates were a penalty and could not be recovered,

When considering whether or not a contract provision is unjust, thought must be given to whether or not it truthfully compensates for a loss that might occur or is some extra obligation. If it is an extra obligation, it is a penalty and cannot be recovered.

The articles contained in this newsletter are in the nature of general comment only. The articles are neither intended nor should be taken to be, advice in respect of any particular matter. Advice should be sought in relation to particular circumstances.

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>> RESTRAINING THE APPOINTMENT OF A RECEIVER

The difficulty of restraining the appointment of a Receiver should not be underestimated...

On 1 March 2010 the Supreme Court of New South Wales delivered its decision in *Brighten Pty Ltd v Bank of Western Australia*.

In late 2006, Noble Growth Investment Ltd applied for a loan to purchase the Fairmont Resort at Leura. The bank advanced \$32,150,000.00 to Noble. The loan was guaranteed by the owner of the land, Brighten Pty Ltd.

In April 2009, Channel 9 aired two items on the television program A Current Affair that were critical of the resort. The bank argued that these reports had an impact on the resort's business. The bank argued that this was a material adverse change and was therefore an event of default under the loan and guarantee documents. In December 2009, by agreement, the Court appointed a Receiver with limited enquiry powers. The Receiver was to report to the Court and did so in February 2010. An injunction was in place to restrain the appointment of a Receiver on a full basis. That injunction was to expire at 5.00 pm on 25 February 2010. The matter was brought before the Court on an urgent basis on the morning of 25 February 2010 to argue for an extension of the injunction. The bank had indicated that in its view the position had so deteriorated that it wanted to appoint a private Receiver if there was no continuation of the injunction.



The Court repeated the principles that the Judge must consider when granting an injunction. The first is that there is a serious question to be tried and the balance of convenience favours the granting of the injunction. A serious question to be tried means that the party seeking the injunction must prove that it has a serious not a speculative case which has a real possibility of succeeding. It must then go on to show that its property or interest would be jeopardised if it were not granted the injunction.

The Judge reviewed the loan and guarantee documents and pointed out that it was a default if in the opinion of the bank, there had been a material adverse change in the borrower or guarantor's financial condition.

The borrower argued that there had been no default or in the alternative that the bank had no entitlement to enforce the default provisions because it was in breach of the ASIC Act or the Trade Practices Act or their conduct was unconscionable under the general law. The borrower argued that the controller of the company, Mr Kwok, did not speak or understand English well and therefore was disadvantaged. The Court rejected this because Mr Kwok was a very experienced businessman and had done many similar transactions involving considerable sums of money. The Court accepted the bank's argument that there had in fact been a default.

The Court found that there was no reason to extend the injunction to prevent a Receiver being appointed because the borrower had not made out a case that had a real prospect of succeeding and the bank should be entitled to exercise its rights under the loan and guarantee documents.

The lesson to be learnt from this case is that care should be taken when considering making such an application for an injunction that there are real prospects of succeeding on the ultimate claim against the financier.



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Jackson Lalic Lawyers

Level 7, 217 Clarence Street, Sydney, NSW, 2000

T: (02) 9262 1770 F: (02) 9262 1771 DX: 13132 Sydney West

Post: PO Box Q245 Queen Victoria Building Post Office Sydney 1230.