

# CASE IN BRIEF:

## TORCHLIGHT FUND NO 1 LP

### NZHC 2559

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This case concerned an application by the plaintiff, a private equity fund investing in distressed assets, for a declaration that a late payment fee was a penalty and, accordingly, unenforceable.

#### Background

Torchlight held an investment in a debt from the Bank of Scotland International, in the amount of AUS\$185 million. All but AUS\$37 million of that sum was repaid by Torchlight by mid-2012. The balance was due on 17 August 2012 (following an agreed extension to the original repayment date of 23 July 2012). However, Torchlight was at that time in a difficult liquidity situation. To settle the remainder, Torchlight entered into a bridging finance arrangement (the **Financing Contract**) with a high net worth Australian individual (the **Lender**). The arrangement was a 60-day contract under which the Lender would discharge the remainder of the debt and, in return, Torchlight would repay the principal with interest at 5.25% callable on day 60, with an additional AUS\$5 million due 20 days following the day of the advance. Of particular interest in this case, the Financing Contract went on to provide for a *late payment fee* in the amount of AUS\$500,000 per week.

Torchlight failed to make the repayments under the Financing Contract and was placed into receivership, following which Torchlight sought to dispute the *late payment fee*.

The alleged liability under the *late payment fee* clause was in excess of AUS\$30 million. In addition to this sum, the Lender claimed its own cost of funds, interest as stipulated under the Financing Contract, and in excess of NS\$1 million for receivers' costs and disbursements. Torchlight sought a declaration that the *late payment fee* comprised an unenforceable and irrecoverable penalty.

It should be noted that the relevant law (except as otherwise agreed by the parties) was that of New South Wales).

#### Penalty doctrine

The first issue considered by the Court was whether the penalty doctrine was engaged in light of the circumstances of the case. This is an issue of construction of the contract, specifically, an assessment of whether the late payment fee was a sum payable for an additional benefit or, otherwise, a sum payable upon breach or as a secondary collateral stipulation.

Neither of the parties adduced expert evidence as to the law relating to construction of contracts, instead, the Court was invited by agreement to apply the relevant principles of New Zealand law, as set out in *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5.

The Court determined that the late payment fee clause did engage the penalty doctrine as it was collateral to the breach and, accordingly, an obligation arising secondary to the obligation to repay. In other words, the collateral stipulation was in the nature of a security for the primary obligation to repay.

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## Penalty or genuine pre-estimate of damage

As noted by Muir J, despite the applicability of New South Wales law, the principles relevant to this issue are familiar 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 (para 82). The question is one of substance rather than form.

The Court ultimately held that the clause was unenforceable as it considered the clause was inserted in *terrorum* for the collateral purpose of enforcing repayment of the principal sum due under the Financing Contract, rather than as a genuine pre-estimate of damage flowing from a breach.

In addition, the Court also considered that the amount of the late payment fee was disproportionate to any conceivable loss flowing from a breach of the Financing Contract.

The judgment of the High Court is currently under appeal.

## AUTHOR PROFILE

Catherine is an Arbitrator, Adjudicator and Mediator based in Auckland, New Zealand.

She is a Panelist with NZDRC (New Zealand Dispute Resolution Centre) and has previously worked for leading law firms in New Zealand, the UK and the Cayman Islands. Through this broad international experience Catherine has gained extensive expertise in a wide range of commercial litigation matters, including fraud, insolvency, contractual, financial services, tax avoidance and regulatory issues.

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