Neutral Citation Number: [2024] EWCA Civ 721

Case No: CA 2023 001951

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
PROPERTY TRUSTS AND PROBATE LIST (ChD)
MR RICHARD FARNHILL
SITTING AS DEPUTY JUDGE OF THE HIGH COURT
[2023] EWHC 1428 (Ch)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 28 June 2024

Before:

LORD JUSTICE NEWEY
LADY JUSTICE ASPLIN
and
LORD JUSTICE BAKER

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Between:

(1) MRS NURAY HOUSSEIN **(2) HOUSSEIN ALI HOUSSEIN** **(as executor of the estate of Ali Houssein, deceased)** **(3) CEK INVESTMENTS LIMITED**	**Claimants/ Appellants**
- and -	
(1) LONDON CREDIT LIMITED **(2) VICTORIA LIDDELL AND ANNIKA KISBY** **(as joint Fixed Charge Receivers)**	**Defendants/ Respondents**

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Gary Cowen KC, **Alexander Hutton KC** and **Edward Blakeney** (instructed by **Hugh Cartwright & Amin**) for the **Appellants**
Giles Wheeler KC (instructed by **Stephenson Harwood LLP**) for the **First Respondent**
The Second Respondents were not represented and did not appear

Hearing dates: 22 & 23 May 2024

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Approved Judgment

This judgment was handed down remotely at 10.30am on 28 June 2024 by circulation to the parties or their representatives by e-mail and by release to the National Archives.

Lady Justice Asplin:

1. This appeal is concerned with the proper construction of the interest provisions in a facility agreement dated 20 July 2020 (the "Facility Letter") and the costs orders which were made by Mr Richard Farnhill, sitting as a Deputy High Court Judge in the Business and Property Courts. The neutral citation for the judge's judgment following the trial is [2023] EWHC 1428 (Ch) (the "First Judgment") and reference should be made to it for the full detail of the background to this matter. The challenges made by the Appellants are to the judge's order made after the consequential hearing, dated 19 September 2023 and sealed on 25 September 2023 (the "Order") and, in particular, to the declarations he made in relation to interest and costs.

2. In particular: at paragraph 3(iii) it was declared that the default interest rate under the Facility Letter was an unlawful penalty which is unenforceable; at paragraph 3(viii) it was declared that pursuant to clause 12.5 of the Facility Letter, contractual interest is payable after the Repayment Date (as defined in the Facility Letter) on any unpaid sums at the rate specified in clause 6.1, being 1% per month, such interest to be calculated on the basis of a year of 365 days, to accrue on a daily basis and to be compounded monthly; and as a result, at paragraph 3(ix) it was declared that "by consent, the amount of interest on the Repayment Sum calculated at the aforesaid rate and accrued from the Repayment Date to the date of the adjourned Consequential Hearing is £181,116.98 and therefore the total sum payable at the date of the adjourned Consequential Hearing is £811,108.77."

3. In summary, the grounds of appeal in relation to those declarations as to interest are that the judge erred in his construction of the Facility Letter, and clause 12.5 in particular, in holding that interest continued to accrue after the Repayment Date at the rate of 1% per month and should have held that no interest accrued after that date.

4. By a Respondent's Notice and grounds of cross appeal, dated 16 February 2024, sealed on 13 March 2024, amongst other things, the First Respondent, London Credit Limited ("London Credit") seeks to challenge the declaration at paragraph 3(iii) of the Order. It contends that the default interest rate is not a penalty and is enforceable and accordingly, that contractual interest was payable from the "Repayment Date" on any unpaid sums at the default interest rate.

5. The Appellants also challenge the costs orders which the judge made. In summary, it is said that he should not have made the costs order at paragraphs 7 – 11 of the Order and, in particular, should not have made an issue based costs order. It is said that he should have awarded the Appellants their costs of the trial on the indemnity basis and that he gave insufficient reasons for his decision. London Credit seeks to uphold the judge's costs orders on additional grounds. I will turn to the costs grounds in more detail below.

Background in outline

6. By the Facility Letter, London Credit agreed to loan £1,845,000 to the Third Appellant, CEK Investments Limited ("CEK") on the terms set out therein. By a deed of variation dated 31 July 2020, that sum was increased to £1,881,000. The terms remained the same, however.

7. The facility was for 12 months from the date of advance with interest on the net advance at the rate of 1% per month. The gross sum included rolled-up interest of £225,720, retained out of the loan, and fees of £75,473. It was secured by: a debenture over the assets of CEK; personal guarantees from CEK's directors Mr Ali Houssein and his wife, the First Appellant, Mrs Nuray Houssein, ("Mrs Houssein"); third-party mortgages over five buy-to-let houses owned by a combination of Mr Ali Houssein, Mrs Houssein and Mr Ali Houssein and Mrs Houssein jointly; and a third-party mortgage over their home at 71 Hamilton Road, Cockfosters, Barnet EN4 9HD. Mr Ali Houssein has since died and his son, the Second Appellant, Mr Houssein Ali Houssein, ("Mr Houssein") is a party to these proceedings in his capacity as his father's executor.

8. Before £1,579,807 was drawn down on 7 August 2020, on 29 July 2020, 71 Hamilton Road was inspected on London Credit's behalf in order to 'verify' that the property was not occupied. There was a dispute at trial about whether the Housseins were aware of the non-occupation condition in the Facility Letter. It has some relevance in relation to costs. Mrs Houssein and her son contended that they were in occupation of the property at the time and intended to remain there. They said that photographs taken during the inspection had been staged to make it appear that the property was vacant.

9. In any event, by a letter dated 8 September 2020, London Credit alleged that CEK was in breach of the covenant at clause 10.2(k) of the Facility Letter by reason of the continued residential occupation of 71 Hamilton Road and was also in breach of an FCA declaration signed by CEK confirming that it, or any person related to it would not occupy 71 Hamilton Road for the duration of the loan. London Credit stated that there had been a material breach of covenant constituting an event of default under clause 12.2 (b) of the Facility Letter and as a result, claimed to be entitled to default interest on the outstanding sum from 7 September 2020, pursuant to clause 6.6 until the breach was remedied. CEK was given a month to do so and it was stated that default interest would cease to apply once the breach was remedied. London Credit reserved its rights to issue a demand and to enforce any securities and/or to commence legal action if the breach was not remedied before 8 October 2020.

10. The Housseins remained in occupation of 71 Hamilton Road and CEK did not pay the sums demanded by way of default interest.

11. By a letter of 3 November 2020, London Credit referred to an alleged breach of the representation and warranty at clause 11.1(h) of the Facility Letter (no intention to occupy 71 Hamilton Road) and demanded immediate repayment of the full amount advanced pursuant to the Facility Letter together with all interest, fees and any commission pursuant to clause 12. It demanded immediate payment of £1,818,518.27, together with further default interest until payment said to accrue at a daily rate of £2,473.64.

12. On 27 November 2020, the Second Respondents, Victoria Liddell and Annika Kisby, informed the Housseins that they had been appointed as receivers and managers in the exercise of London Credit's powers under the legal charge over 71 Hamilton Road and thereafter, they threatened to sell the property. I shall refer to Ms Liddell and Ms Kisby together as the "Joint Receivers". They took no part in this appeal or in the proceedings below.

13. On 11 March 2021, London Credit appointed the Joint Receivers as joint receivers in respect of the five buy-to-let houses. They were due to be auctioned on 13 May 2021. These proceedings were issued on 29 April 2021. The issues were: whether London Credit had waived the requirement that 71 Hamilton Road should be unoccupied and as a result there was no breach of the Facility Letter and no "Event of Default" allegedly entitling London Credit to demand repayment of all outstanding monies and to charge default rate interest; whether the default rate of interest was enforceable as a common law penalty; whether London Credit's appointment of the Joint Receivers was unlawful; whether the Facility Letter was unenforceable as against Mrs Houssein by reason of undue influence; and whether the Facility Letter was unenforceable against the Housseins and CEK by reason of it being a sham and/or section 26(1) of the Financial Services and Markets Act 2000 ("FSMA") and/or sections 140A and 140B of the Consumer Credit Act 1974 and/or section 62 of the Consumer Rights Act 2015.

14. On 12 May 2021, Falk J granted an interim injunction restraining London Credit and the Joint Receivers from dealing with the five buy-to-let properties and 71 Hamilton Road until trial or further order.

15. Although £1,200,000 was repaid on 28 May 2021, the balance of the loan was not repaid on the Repayment Date which was 7 August 2021. The balance of £629,991.79 remains outstanding. At the date of the Order, £181,116.98 of interest had accrued and £811,108.77 was due.

16. The Appellants had made numerous open offers before the Repayment Date:

    i) On 16 March 2021, shortly after the Joint Receivers were appointed in relation to the buy-to-let properties, an offer to pay £1.2 million by the middle of April 2021 and a further £650,000 also by the middle of April was made. It was on the basis that all the securities over both the buy-to-let properties and 71 Hamilton Road were discharged and that the Appellants would pay a "concessionary default interest rate to be agreed";

    ii) A further open offer was made on 23 March 2021. In summary, it reiterated that £1.2 million and £650,000 would be paid but made clear that it would be necessary for London Credit to release its charges over the relevant properties so that further finance could be raised. It also stated that discrete litigation could then take place as to whether London Credit was entitled to default interest;

    iii) On 7 April 2021, another open offer was made under which a payment of £1.85 million was offered by 21 April 2021 on the basis that the charges over three of the buy-to-let properties and 71 Hamilton Road were discharged, immediate steps were taken to discharge the receiverships and on grant of probate in Mr Ali Houssein's estate, a further £350,000 would be paid; and

    iv) A proposal having been floated without instructions on 8 April 2021, a further offer was made on 11 May 2021, without prejudice save as to costs. Mrs Houssein offered to pay £2 million in full and final settlement of all claims. £1.2 million was to be paid as soon as the remortgaging of three buy-to-let properties was completed and a further £800,000 by 9 August 2021, the application for an interim injunction was to be dismissed with no order as to costs and the Joint Receivers to be discharged immediately.

17. Further offers were made after the Repayment Date on 14 October and 1 November 2021. I shall refer to all of the offers both pre and post Repayment Date together as “the Offers”.

The Judgments in outline

18. The judge dismissed the claims that the Facility Letter was a sham and that relief should be granted under the Consumer Rights Act 2015 and/or section 140A of the Consumer Credit Act 1974 at [181]-[188] and [233]-[234] of the First Judgment respectively. He also dismissed the claim that the Facility Letter was not enforceable against Mrs Houssein because her agreement to it had been procured by undue influence of which London Credit had notice [210]-[232]. He held that the photographs of 71 Hamilton Road taken at the inspection on 29 July 2020 had been staged to make it appear that the property was unoccupied, that dishonest evidence had been given in this regard on behalf of both the Appellants and London Credit and that as a result of knowledge of the true state of affairs through its agent, the non-occupation requirement had been waived by London Credit [133]-[147], [159] and [189]-[191]. He also held that the default interest rate payable pursuant to clauses 12.5 and 6.6 of the Facility Letter, was an unenforceable penalty [195]-[209].

19. In relation to the question of whether the default interest rate was a penalty, having referred to *Cavendish Square Holdings BV v Makdesi* [2015] UKSC 67, [2016] AC 1172, which he described as the leading case on penalties and to *Ahuja Investments Ltd v Victorygame Ltd* [2021] EWHC 2382 (Ch) and *Cargill International Trading PTE Ltd v Uttam Galva Steels Ltd* [2019] EWHC 476 (Comm), he held as follows:

> “203. It seems to me that the analysis does not, in fact, get that far. The question is whether the default rate protects a legitimate interest of LCL. That interest cannot be the no residency requirements, since the purpose of that provision was to ensure that there was no breach of FSMA, and in the context of this loan the use of a corporate borrower, CEK, meant that was achieved in any event. I accept the Claimants’ case in that regard.
>
> 204. Charging a higher rate on default can be commercially justified on the basis of the enhanced credit risk of the borrower but it does not seem to me that this was the interest that LCL was seeking to protect.
>
> 205. First, it is certainly the case that the Housseins had credit issues that could legitimately have led a lender to consider them higher risk; Mr Theophanous took into account factors such as the CCJ judgment against Mr Houssein and that this was a second rebridge in setting the base interest rate and this justified a move from 0.7% to 1% per month. That meant that a level of credit risk had already been priced into LCL’s rate, however. I had no evidence on why late payment, even by a short period, justified an increase of a further 3% when 0.3% was sufficient to cover the historic credit risk factors.

> 206. Secondly, the default rate was the same regardless of the breach and was set without reference to the borrower or the particular loan. As Mr Theophanous explained, the default rate was set centrally at 3%; he had no control over it. The LCL Loan was well secured – the LTV was around 54% in circumstances where LCL's guidelines permitted much higher LTVs. If the legitimate interest were credit risk, one would expect some account to be taken of the security, but none was.
>
> 207. Thirdly, the same default rate applied to all breaches. That would mean that LCL required identical protection for each of the following: late payment; residence at a security address (whether or not the loan was to a corporate borrower); final judgments against the borrower in excess of £20,000; and litigation or arbitration threatened or commenced against the borrower. That cannot be right – to take an obvious example, a final and unappealable judgment for £20,000 is a very different thing to a letter of claim for the same amount, yet they are subject to the same default rate.
>
> 208. Finally, the experts agreed that a more typical default rate was 3% in total per month. That obviously does not represent a cap, but in circumstances where there was nothing specific to the Housseins or the security for this loan and where there was nothing specific about the breach, it is hard to see what took this outside the norm to justify an additional 1% per month."

The judge stated that, in the circumstances, he did not believe the default rate protected any legitimate interest of London Credit and that it was a penalty [209]. He went on to clarify that the normal rate of 1% per month was not affected and that he accepted that proper consideration had been given to London Credit's legitimate interests when setting that rate.

20. The judge gave a further ex tempore judgment on 19 September 2023 (the "Second Judgment"), in which he addressed the question of the period for which interest was to run under the Facility Letter. Having stated that there was no dispute about the principles to be applied in relation to the proper construction of the Facility Letter and that they were to be found in *Arnold v Britton* at [15], the judge went on to reject the Appellants' submissions. He held that the ordinary meaning of the language of clause 12.5 is clear. He went on:

> "9. . . . Interest is payable at the rate specified under clause 6.1 or, so far as it is applicable, clause 6.6. Clause 6.6 is never applicable because it is unenforceable as a penalty. That is the effect of the Makdessi decision at paragraph 9. Whether something that is unenforceable still exists as a matter of law is irrelevant to the operation of clause 12.5; if it is unenforceable it cannot be applicable. The penalty issue does not arise in connection with clause 6.1, since it was no part of the claimants' case that the clause 6.1 rate was a penalty. On a plain reading of the language, that rate therefore applies.

> 10. Secondly, there is no inconsistency between that reading of clause 12.5 and clauses 5 or 6. Clause 12.5 creates a vested right which survives "cancellation" of the facility in just the same way that other vested rights survive. Clause 12.5 and 6.6 both deal with default, but the reference in clause 12.5 to "if applicable" clearly contemplates it working in concert with clause 6.6 in that respect. The fact that the parties contemplated that clause 6.6 would typically apply does not therefore affect the reading of clause 12.5 which specified the rate if, for whatever reason and whether that reason was contemplated by the parties or not, clause 6.6 was inapplicable.
>
> 11. Thirdly, had both the clause 6.1 and 6.6 rates been potentially applicable there would have been no uncertainty in affording a party a right of election between two valid remedies. The law on election is replete with cases upholding just such clauses, most obviously where a party has a contractual right to terminate or affirm. In any event, that is not what clause 12.5 does. It does not give the right to the defendant in default to clause 6.6, if that is applicable, but if it defaults to the rate set out in clause 6.6, if that is applicable, but to the rate set out in clause 6.1, if it is not. The argument on uncertainty proceeds on a false basis.
>
> 12. Finally, clause 12.5 does not seek to resuscitate a dead provision in some way, as the claimants sought to suggest. It is clear in referencing the rate referred to in 6.1 and 6.6, rather than seeking to continue clauses themselves after they have by their own terms come to an end. This is not a *Barton v Morris* case since the applicable rate is set out in the facility letter."

21. The judge also addressed the question of costs. Having set out the principles to be derived from CPR 44.2(2), the judge noted that the starting point in this case was unusual. He referred to the fact that he had found that parts of the evidence of Mr Houssein on behalf of the Claimants/Appellants, and Mr Stylianides and Mr Liondaris on behalf of the Defendants/Respondents, had been given dishonestly and that in each case, the elements of the evidence in question was neither minor nor peripheral. In fact, "it formed a significant part of the position advanced and significant time was taken in breaking it down in cross-examination." He added that in his view, it would be "wholly unacceptable for the court to exercise its discretion on costs in favour of parties advancing such evidence so as to allow them to recover the costs of it" [15]. On that basis, he ordered that no costs be recovered in respect of the preparation of the three witness statements in question [16].

22. He then stated at [17] that he did not view either party as an outright winner. He added:

> "17. . . I accept the defendants' submission that C1 and C2 did seek to escape their liabilities in respect of the loan and failed to do so. Equally, the defendants sought a significant sum in default interest and again were unsuccessful. Accordingly, I do not believe that a discount for the recoverability of costs would

> reflect success and failure in this case. The issues on which the parties succeeded were distinct, not sub-parts of a larger issue."

He went on to order the Defendants to pay the Claimants the costs of and associated with the default interest point and the Claimants to pay the Defendants the costs of and associated with the construction point, the FSMA claim, the Consumer Credit Act claim, the Consumer Rights Act claim and the undue influence claim [19].

23. All costs were awarded on the standard basis. The judge had addressed the question of whether costs should be awarded on the indemnity basis in the following way:

> "18. . . . Both parties had reason to fight this case and to fight this case very hard. Mrs. Houssein risked losing her home. London Credit was accused of serious statutory breaches, a point remarked on by the claimants' own expert, Mr. Griffiths. With hindsight, the defendants would have done better accepting a settlement. Equally, the statutory claims, despite their seriousness, ended with something of a whimper at trial. Such things are common in litigation, however. Once the dishonest evidence is taken out of the equation, this case strikes me as robustly fought but not out of the norm so as to justify indemnity costs."

The Facility Letter

24. The opening paragraph of the Facility Letter stated that a loan facility of up to £1,845,000 had been made available subject to the terms of the Facility Letter.

25. Clause 5.1, which appears under the heading "REPAYMENT", provides as follows:

> "Interest due on the Loan shall be paid, together with the Loan amount and all other sums due to the Lender under the Finance Documents, in full by no later than 12 noon on the Repayment Date. The Facility shall be cancelled in full on the Repayment Date."

"Repayment Date" is defined in clause 1.1 as "12 (Twelve) months from the Drawdown Date" and the "Drawdown Date" is defined as "the date on which the Lender's solicitors confirm in writing to the Lender that the Loan has been transferred to the Borrower's specified bank account". Drawdown occurred on 7 August 2020 and therefore the Repayment Date was 7 August 2021.

26. Clause 6 is headed "INTEREST". Where relevant, it provides as follows:

> "6.1 The Borrower shall pay interest on the amount outstanding under the Facility, as from the Drawdown Date and at a rate of 1.00% (One per cent) per month (the "Interest Rate"). The Interest Rate is a discounted rate and assumed strict compliance with the terms of the Finance Documents. Such interest shall be calculated on the basis of a year of 365 days and shall accrue on a daily basis.

> 6.2 The first Interest Period for the Loan shall commence on the Drawdown Date and for each Interest Period thereafter, the last day of the preceding Interest Period.
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> 6.3 The full amount of interest, which is payable pursuant to the terms of this Facility Letter (the "Interest Full Payment"), shall be due and payable on the Drawdown Date and the Loan drawn down on the Drawdown Date shall be utilised towards payment in full of the Interest Full Payment.
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> 6.4 An Interest Period shall not extend beyond the Repayment Date.
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> . . .
>
> 6.6 Default interest:
>
> (i) Upon the occurrence of an Event of Default and/or if the Borrower fails to repay any amount payable by it under any Finance Document on its due date, interest shall accrue on the overdue amount from the due date up to the date of actual payment (both before and after judgment) at the standard rate, being 3.00% (Three per cent) per month above the Interest Rate (the "Default Rate"); and
>
> (ii) Default interest that has accrued under this Facility Letter, shall be due and payable on the last day of each Interest Period and will accrue daily on the balance outstanding on the Facility and shall, to the extent not paid on the last day of each Interest Period, be compounded and shall itself bear interest at the Default Rate."

"Interest Period" is defined in clause 1.1 as ". . . one calendar month".

27. Clause 10 contains covenants. In summary, clause 10.1 provides that the "Borrower", CEK, undertakes to observe and perform the covenants in clause 10 and acknowledges that if it fails to do so in any material respect, the Lender, London Credit, may give notice in writing demanding immediate repayment of the Loan, together with interest, fees and commission. In short, clause 10.2(k) contains a covenant not to occupy 71 Hamilton Road, nor to allow any "Related Person" to do so. The Property is defined to include 71 Hamilton Road and in general terms, "Related Person" is defined to include spouses and relatives of the Borrower. Obviously, this cannot apply to CEK.

28. Clause 11 contained representations and warranties. Clause 11.1(h) is in similar terms to clause 10.2(k). It provides that the "Borrower", CEK, has no intention to occupy the "Property" nor to allow any "Related Person" to do so.

29. Clause 12 is headed "EVENTS OF DEFAULT". In summary, clause 12.1 provides that on the occurrence of an event set out in Clause 12.2, London Credit may give notice in writing demanding immediate repayment of the "Loan" together with interest, fees and commissions and that thereupon the "Borrower", in this case CEK, "shall forthwith

repay the same and the availability of the Facility shall terminate." The demand made on the basis that there had been a breach of the terms relating to the occupation of 71 Hamilton Road purportedly fell within clause 12.2 (b) and/or (c). As I have already mentioned, the judge held that the "non-occupation requirement" had been waived. The event of default which did arise, however, is set out at clause 12.2(a). It is "if the Borrower fails to pay any sums due to the Lender on the due date".

30. The interpretation of clause 12.5 is central to the question of whether interest is due after the Repayment Date and, if so, at what rate. It provides as follows:

> "Any monies falling due for payment by the Borrower pursuant to this Facility Letter and for the time being unpaid shall bear interest at the rate specified in clause 6.1 or 6.6, if applicable, calculated on a day to day basis from the date of so becoming due until the date on which payment is received by the Lender as well after as before judgment. Interest shall be compounded on a monthly basis in these circumstances."

Penalties and Interest after the Repayment Date

31. The question of whether interest is payable on the outstanding sum under the Facility Letter after the Repayment Date at the rate specified in clause 6.1 turns on the proper construction of the Facility Letter. The issue does not arise if London Credit is successful in arguing that the default interest rate under clause 6.6 is not, in fact, a penalty. That is because the Appellants accept that in those circumstances, the default rate of interest under clause 6.6 would be payable after the Repayment Date upon all outstanding sums pursuant to clause 12.5. In the circumstances, it is convenient to consider the question of whether the default rate of interest is a penalty first and then, if necessary, to turn to the issue of whether the rate of interest specified in clause 6.1 continues to apply after the Repayment Date.

Penalty?

The Main Authorities

32. Is the default interest rate under clause 6.6 unenforceable? In the *Cavendish* case, seven members of the Supreme Court decided that the common law rule that a term in a contract which constituted a penalty was unenforceable should not be abolished or restricted but that it should not be extended. Lord Neuberger PSC and Lord Sumption JSC, with whom Lord Carnwath JSC agreed, addressed the nature of a penalty, at [19] - [35].

33. They considered the relevant case law, including *Lordsvale Finance plc v Bank of Zambia* [1996] QB 752. That was a case concerning a contractual provision to increase the rate of interest on a loan during a period of default. Colman J had noted at 763-764 that there would seem to be "no reason in principle why a contractual provision, the effect of which was to increase the consideration payable under an executory contract upon the happening of a default should be struck down as a penalty if the increase could in the circumstances be explained as commercially justifiable, provided always that its dominant purpose was not to deter the other party from breach." Colman J concluded

that the prospective increase in interest rate was commercially justified so long as the dominant purpose was not to deter the borrower from breach.

34. Lords Neuberger and Sumption noted at [28] that Colman J in the *Lordsvale* case and Arden LJ in *Murray v Leisureplay plc* [2005] IRLR 946 had been "inclined to rationalise the introduction of commercial justification as part of the test, by treating it as evidence that the impugned clause was not intended to deter." They considered, however, that:

> "[T]he assumption that a provision cannot have a deterrent purpose if there is a commercial justification, seems to us to be questionable. . . "

and went on to state that:

> ". . . the penal character of a clause depends on its purpose, which is ordinarily an inference from its effect. As we have already explained this is a matter of construction, to which evidence of the commercial background is of course relevant in the ordinary way. But, for the same reason, the answer cannot depend on evidence of actual intention: see *Chartbrook Ltd v Persimmon Homes Ltd* [2009] AC 1101, paras 28-47 (Lord Hoffmann)."

And added that:

> ". . . A damages clause may properly be justified by some other consideration than the desire to recover compensation for a breach. This must depend on whether the innocent party has a legitimate interest in performance extending beyond the prospect of pecuniary compensation flowing directly from the breach in question."

35. They concluded at [31] that the "real question when a contractual provision is challenged as a penalty is whether it is penal, not whether it is a pre-estimate of loss." They went on:

> "31. . . whether it is enforceable should depend on whether the means by which the contracting party's conduct is to be influenced are 'unconscionable' or (which will usually amount to the same thing) 'extravagant' by reference to some norm.
>
> 32. The true test is whether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation. The innocent party can have no proper interest in simply punishing the defaulter. His interest is in performance or in some appropriate alternative to performance. . . ."

They also pointed out that the penalty rule is an interference with freedom of contract which "undermines the certainty that the parties are entitled to expect of the law" and approved Diplock LJ's observation in the *Robophone* case [1966] 1 WLR 1428, 1447,

that "The court should not be astute to descry a 'penalty clause'" [33]. They also observed at [35] that: "In a negotiated contract between properly advised parties of comparable bargaining power, the strong initial presumption must be that the parties themselves are the best judges of what is legitimate in a provision dealing with the consequences of breach."

36. The test of whether a provision amounts to a penalty was addressed in similar terms by Lord Mance JSC at [152]. He noted that there may be interests "beyond the compensatory which justify the imposition on a party in breach of an additional financial burden" and referred to the *Lordsvale* case in that context. He added, also at [152] that:

> ". . . What is necessary in each case is to consider, first, whether any (and if so what) legitimate business interest is served and protected by the clause, and, second, whether, assuming such an interest to exist, the provision made for the interest is nevertheless in the circumstances extravagant, exorbitant or unconscionable. In judging what is extravagant, exorbitant or unconscionable, I consider (despite contrary expressions of view) that the extent to which the parties were negotiating at arm's length on the basis of legal advice and had every opportunity to appreciate what they were agreeing must at least be a relevant factor."

37. Lord Hodge JSC distilled the relevant test at [255] in a similar way:

> "I therefore conclude that the correct test for a penalty is whether the sum or remedy stipulated as a consequence of a breach of contract is exorbitant or unconscionable when regard is had to the innocent party's interest in the performance of the contract. Where the test is to be applied to a clause fixing the level of damages to be paid on breach, an extravagant disproportion between the stipulated sum and the highest level of damages that could possibly arise from the breach would amount to a penalty and thus be unenforceable. In other circumstances the contractual provision that applies on breach is measured against the interest of the innocent party which is protected by the contract and the court asks whether the remedy is exorbitant or unconscionable."

He had also considered the *Lordsvale* decision and had stated at [222] that he considered that decision to be "clearly correct as a default affected the credit risk that the lender undertook."

38. Lord Clarke JSC agreed with the reasoning of Lord Neuberger PSC, Lord Sumption, Lord Mance and Lord Hodge JJSC, save as to a matter which is not relevant here. Lord Toulson JSC agreed with Lord Hodge's and Lord Mance's formulation of the test for a penalty and on all points of general principle, emphasising that "extravagant or unconscionable" are strong words [293]. He also stated at [293] that it is impossible to lay down abstract rules about what may or may not be extravagant or unconscionable because it depends on the particular facts and circumstances in the individual case.

39. The decision in *Cavendish* was applied in the *Cargill* and *Ahuja* cases to which the judge referred and, amongst others, in *Holyoake v Candy* [2017] EWHC 3397 (Ch) and in *Vivienne Westwood v Conduit Street* [2017] EWHC 350 (Ch) to which Bryan J refers in the *Cargill* case. The *Cargill* case was concerned with a number of issues, including whether a clause in an agreement providing for "default compensation" at the rate of 1 month LIBOR plus 12% which applied both pre-judgment and post-judgment was a penalty. Having set out the various formulations of the test for a penalty in *Cavendish*, Bryan J encapsulated the task to be undertaken at [43]. He stated that the question at the first stage was whether the clause in question "imposes a detriment on the contact-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation."

40. He went on to set out part of the summary of the principles to be derived from the *Cavendish* case which Nugee J (as he then was) had elucidated in the *Holyoake* case and the explanation given by Mr Fancourt QC, as he then was, in the *Vivienne Westwood* case. They provide a helpful outline and so I will set them out again here:

> "47. The principles to be derived from *Cavendish* were summarised by Nugee J in *Holyoake v Candy* [2017] EWHC 3397 (Ch) at [467]. I will not set them all out, but sub-paragraph (4) in particular is relied upon by Ms Vora who appears on behalf of the Uttam:
>
> > "4. Where the rule applies, the test for whether a contractual provision is a penalty is whether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation (per Lords Neuberger and Sumption at [32]); what is necessary in each case is to consider first whether (and if so what) legitimate interest is served and protected by the clause and, second, whether, assuming such an interest to exist, the provision made for the interest is nevertheless in the circumstances extravagant exorbitant or unconscionable (per Lord Mance at [52]); the correct test is whether the sum or remedy stipulated as a consequence of breach of contract is exorbitant or unconscionable when regard is had to the innocent party's interest in the performance of the contract (per Lord Hodge at [255])."
>
> 48. Reference has also been made before me today to the case of *Vivienne Westwood v Conduit Street* [2017] EWHC 350 (Ch) where Fancourt J said as follows at paragraph 41:
>
> > "41. The *Cavendish* case shows clearly that, in considering whether a contractual stipulation is or is not a penalty, one must address first the threshold issue - is a stipulation in substance a secondary obligation engaged upon breach of a primary contractual obligation; then identify the extent and nature of the legitimate interest of the promisee in having the primary obligation performed, and then determine whether or

> not, having regard to that legitimate interest, the secondary obligation is exorbitant or unconscionable in amount or in its effect.””

41. The *Ahuja* case was concerned with fraudulent or alternatively negligent misrepresentations allegedly made during the course of a sale of a commercial investment property. There was a parallel claim for damages for breach of contract. The value of the primary claim was said to be in excess of £8.7 million, less the sum of £800,000 advanced under a loan agreement together with interest which had fallen due under the loan agreement before its purported rescission. One of the issues was whether the interest provisions in the loan agreement amounted to an unenforceable penalty.

42. HHJ Hodge QC, sitting as a judge of the High Court, decided that the default interest rate of 12% per month, compounded monthly, representing a 400% increase in the interest rate prior to default, was obviously extravagant, exorbitant and oppressive so as to constitute a penalty. At [143], he stated that he accepted that a lender has a "legitimate commercial interest in applying a higher rate of interest to a borrower which is in default because such a borrower represents an increased credit risk." He quoted Bryan J in the *Cargill* case at [50] in support of that proposition. Bryan J had stated:

> "… it is self-evident … that there is a good commercial justification for charging a higher rate of interest on an advance of money after a default in repayment. The person who has defaulted is necessarily a greater credit risk and 'money is more expensive for a less good credit risk than for a good credit risk'."

43. He went on at [144] to conclude that the "real question for determination in any particular case is whether the borrower has demonstrated, on the balance of probabilities, that the default interest rate applied because of the increased credit risk presented by a defaulting borrower is nevertheless, in all the circumstances, extravagant, exorbitant, or unconscionable." He added that:

> "Whilst I would be prepared to accept, without supporting evidence, an increase of up to 200% in the applicable rate of interest on default to reflect the greater credit risk presented by a defaulting borrower, in my judgment, and as a rule of thumb, I would expect an evidential burden to pass to a lender to adduce evidence to justify any greater increase, at least where the lender enjoys additional personal and real security for its loan."

Submissions in outline

44. Mr Wheeler KC, who appeared on behalf of London Credit, submitted that the authorities show that it is accepted that the lender has a legitimate interest in the repayment of a loan and a higher rate of interest after default was commercially justified. As a result, the only question was whether the rate was exorbitant, extravagant or unconscionable. He says that there are five principles which can be distilled from the authorities. They are that: (i) in order to be a penalty, the effect of the provision must be out of all proportion to the legitimate interest in performance; (ii) the lender has a self-evident interest in repayment of a loan on time; (iii) it is recognised that a default rate of interest is a legitimate mechanism to protect a lender's interests and takes

account of the changed circumstances following a default, subject to it not being extortionate; (iv) a penalty is obvious when one sees it and it should not be forgotten that "exorbitant" is a strong word which creates a high hurdle; and (v) whether a provision is exorbitant is a matter of construction to be approached on an objective basis. It cannot turn, therefore, on the lender's internal rationalisation of the level at which the rate is set.

45. Mr Wheeler submits that the judge failed to apply the correct test here. He says that he relied upon subjective matters when determining whether there was a legitimate interest being protected and did not consider whether the rate was extortionate at all and if he did, he also adopted a subjective approach. He proceeded on the basis at [204] that a higher rate post default "can be" commercially justified rather than "is" justified and approached the matter on the subjective basis of what he considered London Credit was seeking to do and continued on a subjective basis at [205]. It is said that the judge's reliance upon pre-default matters shows his confused and subjective approach. At [206], Mr Wheeler says that the judge applies a subjective approach once again and also disregards the inherent interest in repayment of the loan. Mr Wheeler submits that the reliance at [207] on the fact that the default rate is the same for all breaches is misplaced. It does not mean that a legitimate interest is not being protected. He also criticises the reasoning at [208] on the basis that it appears that the judge is seeking a justification for a particular rate of interest rather than determining whether it was "extortionate". If this is all taken with the conclusion at [209], Mr Wheeler submits that the judge failed to apply the *Cavendish* test at all.

46. On the other hand, Mr Cowen KC, who appeared with Mr Hutton KC and Mr Blakeney on behalf of the Appellants, says that the sense of the judge's conclusions is clear. He recognised the correct test and applied it. In order to be able to determine whether a provision is extortionate, extravagant or unconscionable, one has to determine the extent and nature of the legitimate interest which is intended to be protected, if any, and as Lord Toulson pointed out at [293] in the *Cavendish* case, it is impossible to lay down abstract rules about what may or may not be extravagant or unconscionable because it depends on the particular facts and circumstances in the individual case. Mr Cowen says that that is what the judge did on the facts of this case.

47. In fact, Mr Cowen submits that the judge answered both the second and the third questions as posed by Mr Fancourt QC as he then was (is there a legitimate interest to be protected and what is its nature and extent; and is the provision extortionate, extravagant or unconscionable) and that his treatment of the evidence was similar to the approach adopted in the *Ahuja* case. Mr Cowen submits, therefore, that the judge came to an evaluative judgment in relation to whether the default interest provision was extortionate and applying the test in *Re Sprintroom Ltd* [2019] BC 1031 at [76] there is nothing to justify us disturbing his conclusion.

Conclusions

48. I agree with Mr Wheeler that the judge failed to apply the correct test. To put the matter another way, he failed to ask himself the correct questions. First, he did not address expressly what Mr Fancourt QC described as the threshold question. He did not consider whether the default rate of interest in clause 6.6 is a secondary obligation which is engaged on the breach of a primary contractual obligation. It is implicit, however, and I assume that it was not in issue.

49. Secondly, it seems to me that although [203] - [209] of the First Judgment appears to be focussed on the extent and nature, if any, of the legitimate interest to be protected, it is not clear that the judge was considering legitimate interest alone. When considering the circumstances of this case, he does not appear to have taken any real account of Bryan J's conclusion in the *Cargill* case that it is self-evident that there is a good commercial justification for charging a higher rate of interest on an advance of money after a default in repayment because a person who has defaulted is, inevitably, a greater credit risk. He also does not appear to have taken account of Lord Hodge's approach to the *Lordsvale* decision in the *Cavendish* case an approach which was not disapproved by Lords Neuberger and Sumption. At [28], they emphasised that the assumption that a provision cannot have a deterrent purpose if there is a commercial justification was questionable. They were not addressing the issue of legitimate interest.

50. At [204], for example, the judge makes reference to the concept of legitimate interest but then comments that he did not consider that that was what London Credit were trying to do. As I explain below, it seems to me that at best, that is to confuse the question of legitimate interest (which it seems that the judge accepted could exist in the circumstances) with the effect of the clause in question and to approach that question in an impermissible way. Further, at [209] he states that in the circumstances, he does not believe that the default rate protected any legitimate interest. The circumstances which have been taken into consideration at [203] – [208] do not go to the question of legitimate interest, however. It seems to me, therefore, that although [203] – [209] refer to legitimate interest, the judge approached the issue in an illegitimate and confused manner.

51. He also adopted an impermissible approach. Lords Neuberger and Sumption made clear in the *Cavendish* case that whether a clause is penal depends on its purpose, which is an inference from its effect and that determining this issue is a matter of construction. As they stated at [28], evidence of the commercial background is relevant to the task of construction but the answer cannot depend on evidence of actual intention. At [204], however, the judge appears to take a subjective approach. He refers to what it seemed to him that London Credit was seeking to protect. The same is true of his approach at [205] and [206].

52. It seems to me that in the circumstances of this case and taking into account *Cavendish* and the approach of Bryan J in the *Cargill* case, it is inevitable that a legitimate interest in the enforcement of the primary obligation to repay the Loan, all interest, fees and commissions on the Repayment Date arises here.

53. Thirdly, in my judgment, the judge did not address the crucial question of whether the provision is extortionate, exorbitant or unconscionable separately or at all. He makes no reference to whether he considered the default rate of interest to be extortionate, extravagant and/or unconscionable and does not appear to apply the *Cavendish* test. As Mr Wheeler submitted, at [208], for example, the judge appears to be looking for a justification for the default rate of interest rather than considering whether the rate is extortionate.

54. It seems that the judge misunderstood the second question posed by Mr Fancourt QC in the *Vivienne Westwood* case and failed to address the third. Although he used the phrase "legitimate interest", his reasoning does not suggest that he was considering the extent and nature of London Credit's interest after default. Secondly, he did not address

the question of whether the default interest provision was extortionate, extravagant and/or unconscionable in the light of the nature and extent of the legitimate interest.

55. Mr Wheeler submitted that if we were to hold that the judge had failed to apply the *Cavendish* test properly (which he submitted was the case) and, in particular, if we were to hold that he had failed to determine whether the default rate of interest was extortionate, exorbitant or unconscionable, we should carry out the exercise ourselves. Mr Cowan sought to contend that there was material upon which it was open to the judge to make his decision. To that end he took us to extracts from the experts' reports and to passages in the cross examination of Mr Griffiths, the Appellants' expert, which he said pointed to the conclusion that the default interest rate is extortionate.

56. It seems to me that we are not in a position to substitute our own decision for that of the judge. It would be unreliable and unsafe if we were to do so because it would be based on a limited knowledge of the evidence and cross examination to which we were referred. It is not appropriate for us to decide the point based on the small number of extracts from the expert evidence to which we were taken.

57. If my Lords, Lord Justices Newey and Baker agree, it will be necessary to remit the question of whether, in this case, having regard to the legitimate interest in the performance of the primary obligation, the default interest provision is extortionate, extravagant or unconscionable in amount or effect.

Clause 6.1 interest after the Repayment Date

58. If that question is remitted to be decided by the judge and if the judge decides that the default interest provision was not extortionate and was not, therefore, a penalty, the question of whether clause 6.1 interest applies after the Repayment Date will not arise. If, however, he decides that the rate is extortionate/unconscionable the proper construction of clause 6.1 will be relevant. It seems to me, therefore, that we should address this issue at this stage.

59. Not surprisingly, there is no dispute about the principles which must be applied in relation to the proper construction of the Facility Letter. They are to be found in *Arnold v Britton* [2015] AC 1619 and *Wood v Capita Insurance Services Ltd* [2017] A 1173. They were summarised once more in *EMFC Loan Syndications LLP v The Resort Group Plc* [2021] EWCA Civ 844 per Lady Justice Carr, as she then was:

> "56. The relevant well-known legal principles of contractual construction are non-contentious and to be found in a series of recent cases, including *Rainy Sky SA v Kookmin Bank* [2011] 1 WLR 2900; *Arnold v Britton* [2015] AC 1619 and *Wood v Capita Insurance Services Ltd* [2017] AC 1173.
>
> 57. In summary only then, the court is concerned to identify the intention of the parties by reference to what a reasonable person having all the background knowledge which would have been available to the parties would have understood the language in the contract to mean. It does so by focusing on the meaning of the relevant words in their documentary, factual and commercial context. That meaning has to be assessed in the light of the

> natural and ordinary meaning of the clause, any other relevant provisions of the contract, the overall purpose of the clause and the contract, the facts and circumstances known or assumed by the parties at the time that the document was executed and commercial common sense, but disregarding evidence of the parties' subjective intention. While commercial common sense is a very important factor to be taken into account, a court should be very slow to reject the natural meaning of a provision as correct simply because it appears to be a very imprudent term for one of the parties to have agreed. The meaning of a clause is usually most obviously to be gleaned from the language of the provision. Where the parties have used unambiguous language, the court must apply it; if there are two possible constructions, the court is entitled to prefer the construction consistent with common sense and to reject the other (see *Rainy Sky SA v Kookmin Bank* (supra), at paras 21 and 23).
>
> 58. In *Wood v Capita Insurance Services Ltd* (supra), at paras 9–11 Lord Hodge JSC described the court's task as being to ascertain the objective meaning of the language which the parties have chosen to express their agreement. This is not a literalist exercise focused solely on a "parsing of the wording of the particular clause"; the court must consider the contract as a whole and, depending on the nature, formality and quality of drafting of the contract, give more or less weight to elements of the wider context in reaching its view as to that objective meaning. The interpretative exercise is a unitary one involving an iterative process by which each suggested interpretation is checked against the provisions of the contract and its commercial consequences investigated."

Submissions in outline

60. Mr Cowen submitted that the way in which the Facility Letter was intended to operate was clear from the natural and ordinary meaning of the words used. He says that during the term of the facility, interest accrued at the standard rate of 1% per month pursuant to clause 6.1. The full amount of interest due during the twelve-month term (assuming compliance with the terms of the Facility Letter) was payable at the beginning on the Drawdown Date and the Loan was to be utilised to pay it (clause 6.3). Further, no "Interest Period" was to extend beyond the Repayment Date (clause 6.4). As I have already mentioned, Mr Cowen accepts that beyond that date, or if there was an event of default before that date, the default interest rate would apply (clauses 6.6 and 12.5).

61. Mr Cowen emphasised that all the clause 6.1 "standard rate" interest was payable when the loan was drawn down and that clause 6.4 provides that an "Interest Period" shall not extend beyond the Repayment Date. He says, therefore, that reading these provisions together, it is clear that the standard clause 6.1 rate of interest applies during the term of the loan only and as a result of clause 6.3 was "paid" at the beginning of the term. Although he did not emphasise it in his oral submissions, in his written submissions, Mr Cowen also relied upon clause 5.1 which he says, reinforces such a construction. It provides that interest due on the Loan shall be paid with the Loan and

all sums due by no later than 12 noon on the Repayment Date and that the "Facility shall be cancelled in full" on that date.

62. Furthermore, he says that the interest rates in clause 6.1 and 6.6 are alternatives and there is no right to an election between them whether under clause 6 or clause 12.5 to which I shall refer. He draws attention to the fact that clause 6.6(i) provides that if the conditions are met, interest at the default rate "shall accrue" on the overdue amount. He submitted that clause 6.6(i) was concerned with accrual of interest at the default rate and that clause 6.6(ii) dealt with when that interest was "due and payable". It provides that it is due and payable on the last day of each Interest Period and that it shall be compounded. He pointed out that clause 6.4 makes clear that an Interest Period shall not extend beyond the Repayment Date. As a result, he submitted that clause 6.6(ii) does not operate beyond that date.

63. This all lays the ground for Mr Cowen's submission that the judge was wrong to view clause 12.5 as a freestanding provision. He submits that it merely reiterates what has gone before, but even if he is wrong about that, the natural and ordinary meaning of the Facility Letter read as a whole, is that in all the circumstances, the standard rate of interest under clause 6.1 ceases to apply if there is an Event of Default and otherwise, at the latest, at the Repayment Date.

64. In relation to clause 12.5, he says that it makes reference to two different rates of interest and provides that monies unpaid shall bear interest at the rate which is applicable in the circumstances. Only one rate can apply at any time and the answer to the question of which rate applies is binary. Clause 6.6(i) makes clear that interest at the default rate "shall accrue" in particular circumstances and similar wording is used in clause 12.5. It provides that unpaid sums "shall bear" interest at the rate "in clause 6.1 or 6.6, if applicable". He also emphasises the use of "or".

65. Mr Cowen submits, therefore, that after the Repayment Date standard rate interest under clause 6.1 no longer applies and default rate interest under clause 6.6 would apply to the sums which had not been repaid but an obligation to pay interest at that rate cannot be enforced because it is a penalty. As a result, no interest is payable.

66. He says that the judge was wrong, therefore, to decide that interest continued to be payable on the sums outstanding after the Repayment Date at the rate of interest referred to in clause 6.1. In particular, he says that the judge was wrong to equate "applicable" in clause 12.5 with "enforceable". At [9] of the Second Judgment, the judge stated that "[C]lause 6.6 is never applicable because it is unenforceable as a penalty" and "if it is unenforceable it cannot be applicable". In doing so, Mr Cowen says that the judge stepped outside the matters which are admissible for the purposes of construction. The fact that the default interest rate was (or might be) a penalty would not have been known to the parties at the time the Facility Letter was executed. Mr Cowen also submits that the judge was wrong at [9], [11] and [12] of the Second Judgment to decide that as the default rate of interest is not available, the provisions require one to revert back to the standard rate under clause 6.1.

67. Mr Cowen emphasised that this is not a harsh result. It is London Credit which included default rate interest at a rate which the judge found to be a penalty and in any event, they seek to pursue a claim for statutory or equitable interest. He pointed out that if the default interest rate applies there is £1.7 million outstanding in interest alone.

68. Mr Wheeler, on behalf of London Credit, drew attention to the fact that Mr Cowen had accepted that clause 6.6 is concerned with the situation up to the Repayment Date. Mr Wheeler agrees and says that clause 12.5 is designed to deal with the situation afterwards. He says, however, that if Mr Cowen is right, post Repayment Date, the standard rate of interest under clause 6.1 would never be "applicable" for the purposes of clause 12.5. He submits that the standard rate in clause 6.1 is not time limited and it expressly applies to amounts outstanding under the Facility Letter. If the rate under clause 6.6 is a penalty, one falls back on the clause 6.1 rate. If the clause 6.6 rate is not enforceable, it is not applicable. There is no reason why the parties would not have understood that at the time of execution of the Facility Letter.

Conclusions

69. Taking into account all relevant matters and seeking to construe clause 12.5 in the light of the Facility Letter as a whole and clause 6 in particular, it seems to me that the judge was wrong to decide that standard rate interest under clause 6.1 applies after the Repayment Date.

70. The natural and ordinary meaning of the words used in clause 12.5 is that it applies to monies falling due for payment which remain unpaid. It is a sub-clause of clause 12 which is concerned with "Events of Default" which expressly include failure to pay a sum due on the due date (clause 12.2(a)) but also include events which clearly occur before the Repayment Date. It seems to me, therefore, that there is not necessarily a hard line of before and after Repayment Date which Mr Wheeler and, for that matter, Mr Cowen urged upon us. Clause 6.6(i) provides that it applies on the occurrence of an Event of Default "and/or" if the Borrower "fails to repay any amount payable by it under any Finance Document on its due date." In those circumstances it provides that interest "accrues" at the default rate. In other words, it sets out the rate which applies in the circumstances described. That sub-sub-clause is not time limited. I agree, however, that clause 6.6(ii) is concerned with the period before the Repayment Date. It makes express reference to default interest which has accrued being payable at the end of each Interest Period. They only run until the Repayment Date (clause 6.4).

71. Clause 12.5 makes clear that monies which have fallen due for payment bear interest at the rate specified in clause 6.1 or 6.6, if applicable. It seems to me that that is a simple reference to two rates which have already been defined and explained earlier in the Facility Letter. If one turns to clauses 6.1 and 6.6, it is obvious that they apply in different circumstances. It seems to me, therefore, that the phrase "if applicable" is intended to refer to the circumstances in which the different rates apply and therefore, to the rate applicable in those circumstances. That is the natural and ordinary meaning of the phrase when read in the context of clause 12.5 as a whole and in the light of clauses 6.1 and 6.6.

72. In my judgment, there is no room for an interpretation which allows either the standard rate under clause 6.1 or the default rate under clause 6.6 to spring back if the other rate is not "applicable". There is no "choice" to be made. Whether the standard rate or the default rate applies depends upon the relevant circumstances. If the circumstances are such that default rate interest under clause 6.6 applies, it is "applicable". If that is the case, the circumstances will not be such that the standard rate under clause 6.1 applies. They are mutually exclusive. I agree with Mr Cowen, therefore, that one cannot revert back to applying the standard rate pursuant to clause 6.1 if the circumstances are such

that clause 6.6 would apply but the provision is found to be unenforceable. Clause 12.5 does not provide for a fall back. The words used cannot bear that interpretation. I also agree with him that the judge's interpretation elides "applicable" with "enforceable".

73. It is not necessary, therefore, to consider whether clause 12.5 is truly a freestanding provision. It refers back to the standard rate in clause 6.1 and the default rate in clause 6.6 which have already been defined and explained and requires the rate which is applicable to be applied. It also provides for compounding.

74. I appreciate that, in the circumstances which have occurred, it is difficult to see when the standard rate under clause 6.1 would apply. I do not consider that that detracts from the proper interpretation of the natural and ordinary meaning of the words to which I have referred.

75. It follows that I consider that if the default rate of interest is found to be a penalty, in the circumstances of this case, the standard rate of interest will not apply on the sums outstanding after the Repayment Date. Of course, in such circumstances, London Credit may choose to pursue their counterclaim for statutory/equitable interest.

Issue based costs order and costs on the indemnity basis

76. In the light of my conclusions in relation to the question of whether the default interest rate amounts to a penalty, it seems to me that it is inevitable that the judge's costs order will have to be revisited. It is necessary, nevertheless, to address the question of whether the judge erred in making an issue based costs order and in rejecting an award of costs on the indemnity basis.

Issue based costs order

77. Mr Hutton KC, who addressed us on behalf of the Appellants in relation to the grounds of appeal on costs took us to CPR 44.2. It provides as follows:

> "**Court's discretion as to costs**
>
> 44.2
>
> (1) The court has discretion as to –
>
> (a) whether costs are payable by one party to another;
>
> (b) the amount of those costs; and
>
> (c) when they are to be paid.
>
> (2) If the court decides to make an order about costs –
>
> (a) the general rule is that the unsuccessful party will be ordered to pay the costs of the successful party; but
>
> (b) the court may make a different order.
>
> . . .

(4) In deciding what order (if any) to make about costs, the court will have regard to all the circumstances, including –

(a) the conduct of all the parties;

(b) whether a party has succeeded on part of its case, even if that party has not been wholly successful; and

(c) any admissible offer to settle made by a party which is drawn to the court's attention, and which is not an offer to which costs consequences under Part 36 apply.

(5) The conduct of the parties includes –

(a) conduct before, as well as during, the proceedings and in particular the extent to which the parties followed the Practice Direction – Pre-Action Conduct or any relevant pre-action protocol;

(b) whether it was reasonable for a party to raise, pursue or contest a particular allegation or issue;

(c) the manner in which a party has pursued or defended its case or a particular allegation or issue; and

(d) whether a claimant who has succeeded in the claim, in whole or in part, exaggerated its claim.

(6) The orders which the court may make under this rule include an order that a party must pay –

(a) a proportion of another party's costs;

(b) a stated amount in respect of another party's costs;

(c) costs from or until a certain date only;

(d) costs incurred before proceedings have begun;

(e) costs relating to particular steps taken in the proceedings;

(f) costs relating only to a distinct part of the proceedings; and

(g) interest on costs from or until a certain date, including a date before judgment.

(7) Before the court considers making an order under paragraph (6)(f), it will consider whether it is practicable to make an order under paragraph (6)(a) or (c) instead.

. . ."

78. Mr Hutton acknowledged the high hurdle he has to surmount. He accepted that costs are within the discretion of the judge and that he had to show that the judge erred as a matter of principle, exceeded the wide ambit of his discretion, had taken into account irrelevant factors or left relevant factors out of account or was otherwise wholly wrong. As Ward LJ put it at [25] in *Burchell v Bullard & Ors* [2005] 3 Costs LR 507, appeals against orders for costs are notoriously difficult to sustain "because the trial judge has a wide discretion with the result that this court will only interfere with his decision if he has exceeded the generous ambit within which there is usually much room for reasonable disagreement or because, even more unusually, he has erred in principle."

79. Mr Hutton also referred us to the judgment of Hickinbottom LJ in *Kupeli & Ors v Sirketi & Anr* [2019] 1 WLR 1235 at [5] where he made a number of observations about CPR 44.2. They were as follows:

> "In relation to that rule, several points are worthy of note.
>
> (i) In considering orders for costs, the court is of course bound to pursue the overriding objective as set out in CPR r 1.1, i e it must make an order that deals justly with the issue of costs as between the parties. Therefore, when considering whether to make a costs order - and, if so, the order it makes - the court has to make an evaluative judgment as to where justice lies, on the facts and circumstances as it has found them to be.
>
> (ii) Before an appeal court will interfere with the exercise of that discretion, as with any appeal, it must be satisfied that the decision of the lower court was wrong or unjust because of a serious irregularity in the proceedings below: CPR r 52.21(3). No one suggests that there was a serious irregularity in this case.
>
> (iii) Before an appeal court concludes that the costs decision below was "wrong", it must be persuaded that the judge erred in principle, or left out of account a material factor that he should have taken into account, or took into account an immaterial factor, or that the exercise of his discretion was "wholly wrong": see, e g, *Adamson v Halifax plc* [2003] 1 WLR 60, para 16, per Sir Murray Stuart-Smith, adopting (post-CPR) the conventional (pre-CPR) approach he described in *Roache v News Group Newspapers Ltd* [1998] EMLR 161, 172.
>
> (iv) An appeal court will only rarely find that the exercise of discretion below is "wholly wrong", because not only is that discretion particularly wide but the judge below is usually uniquely well-placed to make the required assessment, having heard the relevant evidence."

80. Mr Hutton also says that there was a procedural irregularity here because the judge did not canvas the possibility of an issue based costs order with counsel before making it.

81. Mr Hutton submits that the judge did not carry out the evaluative judgment to which Hickinbottom LJ referred. His first error was to fail to determine which was the

successful party and to work from there. Instead he disallowed the costs of the witness statements of those whom he had adjudged to have given dishonest evidence and then just stated that neither party was an outright winner and went straight on to parcelling out the issues. Mr Hutton points to the judge's reasoning in [17] of the Second Judgment and says that it makes no sense. The Appellants were not seeking to escape their liability in relation to the loan, and it did not follow that "a discount for the recoverability of costs would reflect success and failure" in the case. Mr Hutton says, therefore, that the judge backed out of making the crucial evaluation which was necessary in order to exercise his discretion properly.

82. He says that if he had approached his task in this way and had taken account of the Offers, he would not have fallen into his third error of failing to follow CPR 44.2(7) by awarding issue based costs pursuant to CPR 44.2(6)(f) without first considering whether it was practicable to make an order under CPR 44.2(6)(a) or (c). As set out above, CPR 44.2(6)(a) provides for an order that a party must pay a proportion of another party's costs and CPR 44.2(6)(c) provides for an order for costs from or until a certain date.

83. Then Mr Hutton took us on a detailed tour of the First Judgment. He noted the judge's conclusions about the witnesses and their dishonesty and then turned to each of the claims. He characterised the sham claim as a short legal point which did not take up much time, the consumer claim as very short and the undue influence claim in relation to Mrs Houssein as one on which there was very little evidence and stressed that the judge would have had to assess her anyway. He submitted that the question of whether there had been a breach of the Facility Letter and whether default rate interest was payable were at the heart of the case and that the question of whether there was a penalty was important.

84. He also submitted that the Offers were relevant but that those made on 14 October and 1 November would have to be re-evaluated if default interest was payable. Overall, he submitted that the offers should have been taken into account, and if the Appellants were the successful parties there ought to have been a lower percentage discount because the majority of the litigation would have been unnecessary had they been accepted.

85. In summary, therefore, Mr Hutton says that the judge approached costs in the wrong way. He shied away from deciding which party was the overall winner which is the starting point of the inquiry and therefore, applied the wrong test: *Medway Primary Care Trust & Anr v Marcus* [2011] 5 Costs LR 808 at [46] and *Brit Inns Ltd v BDW Trading Ltd & Anr* [2013] 1 Costs LR 72 at [50].

86. Then he failed to consider CPR 44.2(7) and instead, took conduct out of the equation by dealing with it merely by disallowing the cost of witness statements instead of evaluating it as a factor in accordance with CPR 44.2(5), failed to take account of the Offers and furthermore, and launched into an issue based approach. That Mr Hutton says, was a fetter upon his discretion, in itself: see the *Bullard* case at [30]. In relation to the adoption of an issue based approach, Mr Hutton also took us to a passage in the judgment of Lord Phillips MR in *English v Emery Reimbold* [2002] 1 WLR 2409 at [115] in the following terms:

> "However, we would emphasise that the Civil Procedure Rules requires that an order which allows or disallows costs by reference to certain issues should be made only if other forms of order cannot be made which sufficiently reflect the justice of the case: see rule 44.3(7), above. In our view there are good reasons for this rule. An order which allows or disallows costs of certain issues creates difficulties at the stage of the assessment of costs because the costs judge will have to master the issue in detail to understand what costs were properly incurred in dealing with it and then analyse the work done by the receiving party's legal advisers to determine whether or not it was attributable to the issue the costs of which had been disallowed. All this adds to the costs of assessment and to the amount of time absorbed in dealing with costs on this basis. The costs incurred on assessment may thus be disproportionate to the benefit gained. In all the circumstances, contrary to what might be thought to be the case, a "percentage" order, under rule 44.3(6)(a), made by the judge who heard the application will often produce a fairer result than an "issues based" order under rule 44.3(6)(f). Moreover such an order is consistent with the overriding objective of the Civil Procedure Rules."

The provisions referred to in rule 44.3 now appear in CPR 44.2.

87. Furthermore, Mr Hutton says that the judge's costs order does not reflect the context of the proceedings which was that they were forced upon the Appellants in order to protect the family home in a situation in which it was alleged that there had been an event of default, default rate interest was allegedly accruing and the Joint Receivers had been appointed. All this, Mr Hutton pointed out was based upon the dishonest evidence of Mr Stylianides. Nor did he take account of the fact that it was the Appellants who really gained something from the proceedings. They succeeded in establishing that there was no Event of Default, that default interest was not payable, that it amounted to a penalty and that the Joint Receivers had not been lawfully appointed.

88. He says that the entirely issues-based costs order imposes a Herculean and vastly expensive task for the detailed assessment, which is deeply impractical and is not justified in this case. He submits that if the judge had started from the correct standpoint he would have awarded the Appellants 80% of their costs.

89. In summary, Mr Wheeler emphasised the high hurdle to be surmounted on an appeal in relation to costs. He noted that: at the date of drawdown of the loan both the Appellants and London Credit were aware of the occupation of 71 Hamilton Road; the Appellants could have advanced their case on a more limited basis but chose not to do so; the Appellants' claim that the Facility Letter was a sham had very serious consequences and that deceiving the Financial Conduct Authority, which was, in effect, what was alleged, is a criminal offence; the undue influence case was wide ranging; and that the consumer claims were abandoned on the last day of the trial.

90. He submitted that it was difficult to say who was the overall winner, that the judge was entitled to take the view he did and that it could not be said that he was wholly wrong. He also submitted that although it might have been better had the judge canvassed the

possibility of an issue based order and heard submission upon it, failing to do so before making the order did not amount to a serious irregularity. Lastly, he submitted, that if costs should have been approached on a discounted basis, the position was far from clear cut but that it would be appropriate for the Appellants to recover 60% of their costs, for London Credit to recover 40% of its costs with the two positions being netted off to give the Appellants 20% of their costs.

Conclusions

91. Although the hurdle which has to be surmounted in relation to a challenge to the exercise of discretion on costs is high, it seems to me that it has been surmounted here. The judge should have sought to determine the overall winner. He did not attempt to do so. The "outright winner" to which he referred is something entirely different. Furthermore, it seems likely that he did not carry out the exercise referred to in CPR 44.2(7). He did not consider whether it was appropriate to make an order on a proportional basis or from a particular date before embarking upon an issue based order. His reasoning at [17] of the Second Judgment does not suggest that he fully engaged with the question of whether a proportional order would be more appropriate at all. Furthermore, he did not take conduct into account but having dealt with the cost of witness statements he put it on one side. He also did not consider the impact of the Offers. I conclude somewhat reluctantly, therefore, that he fettered his discretion and did not apply the right test.

92. It seems to me that he should have decided the question of the overall winner and having done so determined whether the costs of that party should be discounted and, if so, by how much. Only if he came to the conclusion at that stage that a proportional award would not be appropriate should he have embarked on an issue based costs order. In the circumstances, it is not necessary to decide whether the failure to seek submissions about whether to make an issue based costs order was a sufficiently serious irregularity to undermine the order in itself. I should add, however, that it was unfortunate that such a course was adopted.

93. If my Lords, Lord Justices Newey and Baker agree with my conclusion in relation to the penalty issue, this matter will have to be remitted to the judge and the costs order will have to be disturbed in any event. The matters which I have set out should be taken into account when further consideration of the costs takes place.

Indemnity costs?

94. Lastly, the question of whether costs should have been awarded on an indemnity basis arises. Mr Hutton accepts once more that there is a high hurdle when seeking to challenge the exercise of discretion in relation to an award of costs and in relation to the basis upon which they are awarded.

95. As Coulson LJ pointed out at [18] in *Thakkar & Ors v Mican & Ors* [2024] EWCA Civ 552, in any costs appeal, the words of Wilson J (as he then was) in *SCT Finance Ltd v Bolton* [2003] 3 All E.R. 434 at [222], are a good starting point. He noted "the heavy burden faced by any appellant in establishing that the judge's decision falls outside the discretion in relation to costs conferred upon him. For reasons of general policy, namely that it is undesirable for further costs to be incurred in arguing about costs, this court discourages such appeals by interpreting such discretion very widely". The same point

was made by this court in *Hislop v Perde* [2018] EWCA Civ 1726; [2019] 1 W.L.R. 201 at [68].

96. That is all the more so in relation to whether to award indemnity costs. Coulson LJ summarised the position in the following way in the *Thakkar* case:

> "19. It is convenient to summarise, without going to the authorities in laborious detail, the general principles applicable to the award of indemnity costs. They are:
>
> "(a) The discretion to award indemnity costs is a wide one and must be exercised taking into account all the circumstances of the case, including but not limited to the conduct of the paying party: see *Three Rivers DC v The Governor of the Bank of England* [2006] EWHC 816 (Comm)); *Digicel (St. Lucia) Limited v Cable and Wireless PLC* [2010] EWHC 888 (Ch); and *Excalibur Ventures v Texas Keystone & Others (No 2)* [2016] EWCA Civ 1144, [2017] 1 W.L.R. 2221 at [21].
>
> (b) In order to obtain an order for indemnity costs, the receiving party must surmount a high hurdle; to be able to demonstrate "some conduct or some circumstance which takes the case out of the norm. That is the critical requirement": see Lord Woolf in *Excelsior Commercial & Industrial Holdings Limited v Salisbury* [2022] EWCA Civ 879, [2022] C.P. Rep. 67 at [32]). Whilst it is preferable for the judge expressly to apply the test of "out of the norm", the use of the word "exceptional" may be consistent with the judge having applied the principles in *Excelsior:* see *Whaleys (Bradford) Ltd v Bennett* [2017] EWCA Civ 2143; [2017] 6 Costs L.R. 1241 at [21] (Newey LJ).
>
> (c) To the extent that the application is based on the paying party's conduct, it is necessary to show such conduct was "unreasonable to a high degree" in order to recover indemnity costs (see *Kiam v MGN Limited* [2002] EWCA Civ 66; [2002] 1 W.L.R. 2810), but it is not necessary to go so far as to demonstrate "a moral lack of probity or conduct deserving of moral condemnation" on the part of the paying party (see *Reid Minty v Taylor* [2002] 2 All E.R. 150).
>
> (d) Merely because the conduct in question may happen regularly in litigation does not mean that such conduct cannot also be 'out of the norm': "in my view the word 'norm' was not intended to reflect whether what occurred was something that happened often, so that in one sense it might be seen as 'normal', but was intended to reflect something outside the ordinary and reasonable conduct of proceedings": see *Esure Services Ltd v Quarcoo* [2009] EWCA Civ 595 at [25], in the judgment of Waller LJ."

97. Mr Hutton also accepts that there is no presumption or starting point which requires a judge to begin by assuming that indemnity costs should be awarded where the case involves dishonesty. See the *Thakkar* case at [20] as follows:

> "Since the judge has such a wide discretion when it comes to costs, the courts have repeatedly made it clear that the court should avoid going beyond the CPR to identify rules, default positions, presumptions, starting points and the like, when addressing costs disputes. Lord Woolf made that point in *Excelsior* at [32]:
>
> > "In my judgment it is dangerous for the court to try and add to the requirements of CPR which are not spelt out in the relevant parts of the CPR. This court can do no more than draw attention to the width of the discretion of the trial judge…"

98. Coulson LJ went on to note as follows:

> "21. As to allegations of dishonesty, there are many cases which demonstrate that, if a claim is found to be dishonest, the judge will very often award indemnity costs against the claimant: see *Three Rivers DC* at [25(5), (6) and (8)], and *Esure v Quarcoo* at [25] – [27]. . . "

99. Mr Hutton submits, that this is a case which was out of the norm. He says that the claim was necessitated as a result of the dishonesty of Mr Stylianides. Had there been no dishonesty, it would not have been alleged that there had been an Event of Default as a result of the occupation of 71 Hamilton Road, the Loan and interest at the default rate would not have been demanded and the Joint Receivers would not have been appointed. But for Mr Stylianides's dishonesty, therefore, Mr Hutton says that the proceedings would not have been necessary. In addition, he says that it was out of the norm not to take proper account of the Offers.

100. Mr Wheeler, on the other hand, points out that there is no general rule in relation to an award of indemnity costs and that it falls within the wide discretion of the judge to decide the basis upon which costs are awarded. In this case, he points out that the judge found that there was dishonest evidence on both sides and that the Appellants' allegation that the Facility Letter had been a sham was a very serious allegation which had failed. He says, therefore, that the conduct balanced out and that it cannot be said that the judge's approach fell outside the wide ambit of the proper exercise of his discretion. Furthermore, he says that the rejection of an offer does not usually lead to costs on the indemnity basis.

Conclusions

101. In my judgment, this aspect of the appeal can be dealt with very shortly. It is clear from the authorities and, in particular, from *Thakkar*, that there is no presumption or starting point that costs must be awarded on the indemnity basis if there is dishonesty. Furthermore, Coulson LJ with whom the Lady Chief Justice and I agreed, makes clear

that whether to award indemnity costs falls within the wide ambit of the judge's discretion which can only be impugned in very limited circumstances.

102. Suffice it to say that in this case, I do not consider that the limited circumstances apply or to put the matter another way, that the heavy burden faced by any appellant in establishing that the judge's decision falls outside the proper exercise of his discretion in relation to costs has been surmounted. The judge was entitled to consider that there was dishonesty on both sides and that in the circumstances, it would not have been appropriate to award the Appellants their costs on the indemnity basis. Although it is possible that the failure to accept an offer or offers might lead to the conclusion that the matter was taken out of the norm, that is not necessarily the case and the judge was entitled to decide as he did.

Conclusion of the Appeal

103. The outcome of this appeal is complicated. First, if my Lords, Lord Justice Newey and Lord Justice Baker agree with me, the question of whether the default rate of interest is a penalty must be remitted to the judge to decide on the basis of the entirety of the evidence which he heard and applying the correct test. If he concludes that there is no penalty, the default rate of interest will apply from the Repayment Date.

104. Secondly, as I have already mentioned, I would allow the appeal in relation to whether clause 6.1 interest is payable after the Repayment Date. In my judgment, no rate of interest under the Facility Letter will apply after the Repayment Date if the default rate is held to be a penalty. The "standard rate" in clause 6.1 ceased to apply at that date and cannot be relied upon to fill a gap, if such gap exists. In those circumstances, it will be for London Credit to seek equitable or statutory interest, if so advised.

105. Thirdly, I would allow the appeal in relation to the issue based costs order. It is inevitable that the question of costs will have to be revisited if the penalty issue is remitted. When determining what costs order to make at that stage, the judge should determine who is the "overall winner", take account of conduct and the Offers where relevant and first determine whether to apply a discount before resorting to an issue based costs order.

106. Lastly, as I have already mentioned, I would dismiss the Appellants' appeal in relation to indemnity costs. In my judgment, the judge was entitled to decide not to award costs on the indemnity basis.

Baker LJ:

107. I agree.

Newey LJ:

108. I also agree.