



ORIGINATION FEE FOUND NOT TO BE A PENALTY OR AN UNJUST TERM WHERE A PROPOSED LOAN DID NOT PROCEED

In an environment of falling property prices and tighter credit, we start to see some interesting cases in the debt financing space. As the banking sector focuses on increased regulatory attention and the remediation work required as a result of the Financial Services Royal Commission, increasing numbers of non-bank lenders are stepping into the void to provide debt funding, particularly in connection with real property transactions. If this trend continues, it is vital such lenders pay close attention to the lending fundamentals if they are to avoid negative publicity and adverse financial outcomes.

One of the common issues that arises in non-bank financing is whether certain contractual terms might constitute a penalty which could be unenforceable. Often associated with any discussion on penalties is the question as to whether a contract is unjust.

The Supreme Court of New South Wales in the decision of Private Mortgages Australia Pty Limited ACN 600 628 813 as trustee for the PMA Trust v Stever [2019] NSWSC 462 recently considered these issues.

While the decision was favourable to the Lender, it does highlight:

1. the importance of clear and unambiguous language when drafting key commercial terms of any agreement (including an indicative offer for finance upon which a lender may seek to rely); and
2. that notwithstanding the lender's success in this instance, consideration should still be given as to whether a party should be required to seek legal advice to assist resisting any claim that a contractual provision may be unfair.

BRIEFLY THE FACTS WERE:

1. The plaintiff, Private Mortgages Australia Pty Limited as trustee for the PMA Trust (**Private Mortgages Australia**) sent a Letter of Offer dated 27 February 2015 to the defendants, Merril Stever and Bruce Maples, pursuant to which the plaintiff was to arrange a loan of \$550,000 to EMIC Holdings Pty Ltd I.I.O.R & A.T.F 165 Donaldson Range Road Unit Trust (**EMIC**). The defendants executed the letter of offer as guarantors.
2. The purpose of the loan was to enable EMIC to purchase a property in Razorback NSW (**the Razorback property**), which the second defendant and his business partner wanted to develop. As circumstances unfolded, the purchase of the Razorback property fell through and the loan did not proceed.
3. The plaintiff claimed that an originator fee in the amount of \$18,150 (**originator fee**) and the balance of legal and administration costs of \$2,750 (**legal/admin fees**) were payable by the defendants as guarantors pursuant to the executed letter of offer.
4. The defendants claimed that the obligation to pay the originator fee was a penalty as the loan did not proceed and that the Letter of Offer was unjust at the time the contract was executed.
5. The executed letter of offer provided:

"Fees: You must pay the following fees in respect of the establishment of the loan:

(a) Originator Fee of 3.3% Including GST

(b) Legal/Admin Fees totalling \$5,500 Including GST of which \$2,750 is payable upon acceptance of this Letter of Offer.....

The above fees shall be deducted from the loan advance in the event that the loan proceeds to settlement. If the loan does not proceed, you will remain liable to Private Mortgages Australia for the fees in accordance with this Letter of Offer."

The execution block in the letter of offer provided:

"4. I / We, the Borrower(s) and the Guarantor(s) hereby direct Private Mortgages Australia to proceed with arranging the preparation of formal loan documentation, engagement of solicitors to act on behalf of the Lender in relation to the loan, and to conduct such further due diligence as may be required by the Lender to proceed with the loan.

5. I / We, the Borrower(s) and the Guarantor(s) agree to pay the Originator Fee, Legal and Admin costs as specified in the letter of offer, and all costs which may be incurred in connection with the loan, to Private Mortgages Australia in consideration of Private Mortgages Australia proceeding with the establishment of the loan in accordance with the direction to proceed set out above."

THE COURT FOUND:

1. The originator fee would not only be payable on settlement of the loan, despite the defendant's submission that any other interpretation would be commercially absurd (for example, if the plaintiff was unable to secure the funds to provide the loan). Her Honour considered the language of the executed Letter of Offer unambiguous. "... the fees were payable in consideration for the plaintiff taking any steps or activities in preparing to advance the loan funds."
2. In the course of submissions the plaintiff conceded, and Her Honour agreed, that there may be an implied term that the defendants' liability for the originator and legal/admin fees would abate if the plaintiff, without reasonable cause, elected not to proceed with the loan.
3. The defendants argued that the requirement to pay an originator fee in accordance with the executed letter of offer was a penalty as it did not amount to any genuine pre-estimate of damages suffered by the plaintiff and was out of all proportion to any damage suffered by the plaintiff. As a result, they said the clause requiring payment of the originator fee should be void and unenforceable.
4. The penalty submission was not accepted. The court noted the definition of a penalty from the High Court in the case *Andrews v Australia & New Zealand Banking Group Ltd* (2012) 247 CLR 205 as follows:

"In general terms, a stipulation prima facie imposes a penalty on a party (the first party) if, as a matter of substance, it is collateral (or accessory) to a primary stipulation in favour of a second party and this collateral stipulation, upon the failure of the primary stipulation, imposes upon the first party an additional detriment, the penalty, to the benefit of the second party."

In the present case, the obligation to pay the originator fee did not arise as a result of the defendants' failure to satisfy an obligation under the executed Letter of Offer. The obligation was found not to be collateral to secure the performance of another promise and was not an obligation that arose as a consequence of the failure to perform another obligation.

5. The defendant alternatively claimed relief on the basis that the obligation to pay the origination fee was unjust in the circumstances relating to the contract at the time it was made. The first defendant, who did not read the executed Letter of Offer, was unsuccessful in this defence, it being noted that the primary cause of her situation was her decision not to read the document. The first defendant was not found to be at a special disability. Her Honour commented that "at the heart of this case is... the first defendant's failure to protect her interests in the circumstances, notwithstanding her ability to do so." Her Honour also noted that while the amounts payable were not a nominal sum and perhaps not a necessity for the protection of the plaintiff's interests given the loan did not proceed, the materiality of the amount claimed and impact on the defendants were relevant factors to take into account in the evaluative process.

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