

**EASTERN CARIBBEAN SUPREME COURT
BRITISH VIRGIN ISLANDS**

**IN THE HIGH COURT OF JUSTICE
(COMMERCIAL DIVISION)**

CLAIM NO. BVIHC (COM) 2020/0047

BETWEEN:

RENISTON LTD

Claimant

and

NEDLANDS OVERSEAS INC

Defendant

Appearances:

Ms. Daisy Bovington of Collas Crill LP
The defendant did not appear

2020: July 28
July 31

JUDGMENT (NO 2)

- [1] **JACK, J [Ag.]:** This matter has now been before the Court for a third time. The procedural history can be seen in my judgment of 2nd July 2020. Given that this action could have been begun as an ordinary action and judgment obtained by default, the waste of Court resources is regrettable. However, it has the fortuitous consequence that judgment will not be given against the defendant for more than it in fact owes.
- [2] The claimant has now managed to produce an amended statement of claim which does show a viable claim in law. The facts are these. On 27th March 2013 (pursuant to agreements of 22nd March 2013) Daferson Developments Ltd lent US\$6.53 million to Severo-Zapadnaya Agropomishlennya Gruppa LLC for a term of three years at an annual interest rate of 5 per cent rolled up. The defendant

gave Daferson a guarantee of Severo's liabilities. The guarantee is governed by English law. It provided, *inter alia*:

"2.1 In consideration of the Lender entering into the Finance Documents, the Guarantor guarantees to the Lender, whenever the Borrower does not pay any of the Guaranteed Obligations when due, to pay on demand the Guaranteed Obligations.

2.2 The Guarantor as principal obligor and as a separate and independent obligation and liability from his obligations and liabilities under clause 2.1 agrees to indemnify and keep indemnified the Lender in full and on demand from and against all and any losses, costs, claims, liabilities, damages, demands and expenses suffered or incurred by the Lender arising out of, or in connection with, the Guaranteed Obligations not being recoverable for any reason or any failure of the Borrower to perform or discharge any of its obligations or liabilities in respect of the Guaranteed Obligations.

...

4.1 The Guarantor shall pay interest to the Lender at the daily rate which is 0,1% on all sums of debts demanded under this guarantee from the due date of the repayment by the Borrower or, if earlier, the date on which the relevant damages, losses, costs or expenses arose in respect of which the demand has been made, until, but excluding, the date of actual payment."

- [3] Severo did not repay the loan in 2016. On 16th August 2018 Daferson assigned to the claimant (a) \$5,847,979.00 of the monies owed by Severo to Daferson and (b) all its rights under the guarantee given by the defendant. Assignment (a) was governed by Russian law; (b) by English law. The original statement of claim was defective in that it did not plead any facts relating to the law of assignments in Russian or English law. In absence of any pleading as to Russian or English law, those laws were presumed to be the same as BVI law, under which the legal assignment of debts is not possible.

- [4] The claimant has now remedied these defects by amendment to its pleading. Assignment (a) is valid under Article 348.2 of the **Russian Civil Code**; assignment (b) under section 136(1) of the **Law of Property Act 1925** (UK).¹
- [5] This leaves the question as to whether the provision for default interest under the guarantee at 0.1 per cent per diem, or 36.5 per cent per annum, is penal. Since this is a point of public policy, the Court has to take the point of its own motion.
- [6] In order to answer the point, the claimant has obtained an expert report on English law from Mr. Paul Mitchell QC. No permission was sought to adduce expert evidence, so his report is not admissible: CPR 32.6(1). Moreover, permission would not have been given, had it been sought. Firstly, it is unnecessary. Secondly, I am far from convinced that Mr. Mitchell QC has properly summarised the range of opinion on the penalty issue, as he is required to do: CPR 32.14(1)(e)(i). Whether I am right or wrong in the views I express below is a matter for a higher court, but I do not believe they fall outside the range of opinions which could credibly be held. Mr. Mitchell QC does not mention *any* contra-arguments to his view whatsoever. (In fairness to him, I should say that bafflingly he does not appear to have been shown my first judgment, so he may not have been aware of the Court's concerns.)
- [7] As the need for the expert report, Barrow JA held in **Alfa Telecom Turkey Ltd v Cukurova Finance International Ltd**² that "courts in this jurisdiction normally determine for themselves, in normal domestic law litigation, the content and meaning of English law without any thought of receiving expert evidence..." This is because all judges of the Eastern Caribbean Supreme Court are trained in English law and all states and territories within the jurisdiction (with the limited exception of St Lucia) have imported English common law and often much English statute law. In the Commercial Division, moreover, most of the judges have practiced in England, including Bannister and Wallbank JJ. Many have judicial

¹ 15 & 16 Geo 5 c 5.

² HCVAP 2007/027 (determined 22nd April 2008, unreported) at para [3].

experience in England. Eder J was a retired justice of the High Court of England and Wales. Kaye, Davis-White, Green JJ and myself were or are authorized to sit in the English High Court. Obtaining expert evidence of English law is particularly otiose in the Commercial Division.

- [8] English law is technically foreign law, so if it is relied upon as being different to BVI law, it must be pleaded. However, as an evidential matter, this Court can take judicial knowledge of it, just as in the nineteenth century the English Court would take cognisance of Irish law: **Reynolds v Fenton**.³ (See also **Celltech Chiroscience Ltd v Medimmune Inc**,⁴ where Jacob J decided points of American patent law on the basis of counsel's submissions "just as if [he] were a US district judge.")
- [9] Accordingly, I shall ignore Mr. Mitchell QC's report as evidence, but instead consider it as submissions. He makes two points: a term of a contract cannot be a penalty if it is a primary liability, rather than a liability which arises only on default (citing **Cavendish Square Holding BV v El Makdessi**⁵); and an uplift in an interest rate in the event of a default should be viewed as penal, "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" (citing **Lordsvale Finance plc v Bank of Zambia**⁶).
- [10] Taking this latter point first, the ratio of **Lordsvale** is more fully set out in the headnote:

"there was 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 its dominant purpose was not to deter

³ (1846) 3 CB 187 at p 191 *per* Moule J. And see Phipson on Evidence (19th Ed, 2017) at para 3-07, although the footnote appears to be an error.

⁴ [2002] EWHC 2167 (Patents) at para [8].

⁵ [2015] UKSC 67, [2016] AC 1172.

⁶ [1996] QB 752 *per* Coleman J at pp 763-764.

the other party from breach; that if an increased rate of interest applied only from the date of default or thereafter, provision for a modest increase in the rate would not be struck down as a penalty; that the rate of 1 per cent. could not be said to be *in terrorem* but was consistent only with an increase in the consideration for the loan by reason of the increased credit risk represented by a borrower in default; and that, accordingly, the default interest provision would be fully enforced.”

[11] The increase of one per cent per annum in that case stands to be contrasted with the 36.5 per cent increase in the current case. The claimant has made no attempt (either on the pleadings or by adducing evidence) to show that such a rate of interest was commercially justifiable. On the contrary it is swinging. I find that the rate is *in terrorem*.

[12] Now **Chitty on Contracts**⁷ suggests that the true test following **Cavendish Square** is:

“whether the party to whom the sum is payable had a legitimate interest in ensuring performance by the other party and the sum payable in the event of breach is not extravagant or unconscionable in comparison to that interest.”

[13] In my judgment, however, these different glosses make no odds in the current case. The increase in interest by 36.5 per cent per annum is exorbitant. No evidence has been adduced, nor have any matters been pleaded, to justify it. The rate of interest is extravagant and unconscionable. Mr. Mitchell QC advances no argument as to how such an enormous rate of interest can be commercially justifiable. Indeed, he concedes that he knows none of the background facts.

[14] Turning then to the first point, Mr. Mitchell QC suggests that the doctrine of penalties cannot apply to primary obligations.

“[A] clause can only be a penalty clause if it is a clause which provides for a certain consequence to follow upon a breach by the defaulting party of

⁷ 33rd Ed, 2019 at para 26-190.

another clause in the agreement. Penalty clauses contain a secondary obligation which arises only on breach of a primary obligation.”

Because the guarantor under clause 2.2 of the guarantee makes itself liable “as primary obligor”, the doctrine of penalties can have no application, he says.

- [15] This, however, ignores the fact that the law looks at substance not form. As the head-note says in **Cavendish Square**:

“*Per* Lord Neuberger of Abbotsbury PSC, Lord Clarke of Stone-cum-Ebony, Lord Sumption, Lord Carnwath, Lord Toulson and Lord Hodge JJSC: The classification of terms for the purpose of the penalty rule depends on the substance of the term and not on its form or on the label which the parties have chosen to attach to it.”

- [16] A guarantee is a classic example of a secondary obligation. Thus, if the rate of interest payable by a guarantor on the breach by the principal debtor of its obligations is otherwise a penalty, the fact that the guarantor assumes its obligations as a primary obligor does not as a matter of substance change the true nature of the obligation. Moreover, refusing to apply the penalty doctrine in the circumstances of the current case would result in significant unfairness. A guarantor who pays the principal creditor is entitled to reimbursement from the principal debtor. (There are exceptions to this rule, but none apply in this case.) Vis-à-vis the principal debtor the increase in interest from 5 per cent to 41.5 per cent would be a penalty. The general rule is that a guarantor is entitled to reimbursement from the principal debtor. This principle would be violated, if the guarantor were left having to pay the principal creditor at the penal rate without any right to repayment from the principal debtor. However, if the guarantor did have a right of reimbursement, the principal debtor would be liable for the penalty rate of interest on his defaulting on the principal debt.

[17] This view has support from **Azimut-Benetti Spa (Benetti Division) v Healey**⁸, where Blair J held that a more stringent clause in the contract of guarantee than in the current case was not sufficient:

“to impose on a guarantor a liability for a sum that is irrecoverable against the principal debtor where the reason for it being irrecoverable is that the sum in question is a penalty. The rule against penalties is ultimately based on public policy. In this regard, I would follow the decision of Clarke J in **Citicorp Australia Ltd v Hendry**,⁹ a New South Wales case. He held, and I agree, that it would be contrary to principle to allow the indirect enforcement of a claim for a penalty in this manner.”

[18] There admittedly the principal debtor had a direct defence that the sums sought were a penalty, but the reasoning of Blair J applies equally to a situation where the penalty stands to be enforced against the principal debtor only via the guarantor. In a tripartite situation, it is irrelevant whether a direct claim lies against the principal debtor or not: what matters is that the guarantor will be having to seek recovery from the principal debtor for monies which the principal creditor could not enforce directly against the principal debtor.

[19] Accordingly, in my judgment the claimant is not entitled to interest at 36.5 per cent. I shall give judgment for the claimant for a sum to be fixed in chambers. The claimant is also entitled to costs, but the basis and amount shall also be fixed in chambers.

⁸ [2010] EWHC 2234 (Comm), 132 Con LR 113. The case is discussed in Andrews and Millett on the Law of Guarantees (7th Ed, 2015) at para 6-019, so why Mr. Mitchell QC did not identify the case in his expert report is unclear.

⁹ (1985) 4 NSWLR 1 at p.21D.

[20] At present, I am minded to limit the costs to the fixed costs payable on a default judgment in an ordinary action, but I will consider any arguments put forward.

Adrian Jack
Commercial Court Judge [Ag.]

By the Court

Registrar