



REPUBLIC OF MALAWI
IN THE SUPREME COURT OF APPEAL
SITING AT BLANTYRE
MSCA CIVIL APPEAL NO. 31 OF 2018

[Being High Court, Commercial Case No. 186 of 2015, Blantyre]

BETWEEN:

INDE BANK LIMITED-----APPELLANT

AND

HARRY GUNDA t/a HALLS PROTECTIVE

CLOTHING AND GENERAL DEALERS-----RESPONDENT

CORAM: THE HON. CHIEF JUSTICE R.R. MZIKAMANDA SC

HON. JUSTICE L.P. CHIKOPA SC, JA

HON. JUSTICE F.E. KAPANDA SC, JA

HON. JUSTICE H.B.S. POTANI JA

HON. JUSTICE J. KATSALA JA

HON. JUSTICE I.C. KAMANGA JA

HON. JUSTICE M.C.C. MKANDAWIRE JA

P. Mpaka/F. Tandwe, Counsel for the Appellant

A. Kauka, Counsel for the Respondent

W. Shaibu, Judicial Research Officer

Mrs. Chimtande/ Mr. Minikwa, Court Clerk

Mutinti/Msimuko, Court Reporters

JUDGMENT

1. This is an appeal brought by the appellant following the judgment of the court below dated 2nd August 2017 in favour of the respondent for the sum of MK56,864,112.90 and interest on the sum as claimed. The background to this case is that the respondent a businessman and customer of the appellant held a current account with the appellant. The appellant and the respondent entered into Loan Agreements/Overdrafts. The first agreement was for the sum of Mk120,000,000.00 and the second agreement was for MK188,000,000.00. Interest payable by the respondent was 44% per annum comprising of 39% per annum plus a margin of 5%. In both agreements the parties agreed that in the event of any default in the repayments of the loans, an additional 10% interest described as “penalty interest” would be levied on the arrears.

2. The respondent defaulted on the 1st loan agreement by 5 months and on the second Loan Agreement by 4 months. The appellant levied and collected penalty interest amounting to Mk56,864,112.90. The respondent not happy with the said penalty interest commenced an action against the appellant whereby he sought refund of the Mk56,864,112.90 million and interest of 1% above the appellant’s lending rate.

3. Aggrieved with the judgment of the Court below, the appellant brought an appeal to the court. The amended grounds of appeal are as follows:

1) The Court below erred in failing to primarily invoke the relevant statutory and/or constitutional guidance in aid of giving meaning and implication to the instruments embodying the parties contract between the parties before the Court below.

2) The decision of the Court below as to the level of the respondent’s knowledge at the time of entering into the contracts and/or to the correct mark-up on defaulting loans for Bank and/or as to the burden of proof on the fairness of the default interest is not supported by the evidence before the Court below and is contrary to the common law and statutory principles upon which a contractual clause can be adjudged unenforceable.

3) The Court below erred in seeking to review the fairness of the respondent’s contractual obligation in aid of or as part of its consideration in determining the enforceability of the default interest clause under the penalty rule.

4) Having decided to determine the parties' legal rights and obligations on the basis of the common law concept under the penalty rule, the Court below erred in failing to identify and apply the true and accurate legal test for determining and identifying a penalty at common law.

5) The Learned Trial Judge erred in awarding the interest as awarded on the judgment sum.

6) The Learned Trial Judge erred in awarding the plaintiff/respondent 15% collection charges.

The appellant sought the relief of reversal of the judgment of the Court below.

4. On 26th April 2022, the respondent pursuant to Order 111 rule 14 of the Supreme Court of Appeal Rules filed a notice of intention to rely upon preliminary objection. The grounds for the said objection were as follows:

- i) None of the grounds of appeal states whether it is based on law or fact;
- ii) Grounds of appeal 1,2 and 3 are vague and difficult to understand, they lack precision and are not concise;
- iii) Ground of appeal 3 is convoluted; it lacks precision and is not concise;
- iv) Ground of appeal 4 looks like an argument.

5. On 29th April 2022 the appellant filed its affidavit in opposition to the preliminary objection.

6. When the court convened on 17th May 2022, we made several observations and directed as follows:

- i) After going through the preliminary objection and the papers that were filed in response to the same, we found that there was no merit in the preliminary objection.
- ii) That the preliminary objection has got no legs on which to stand at this point in time.
- iii) That the parties should address us on the substantive appeal.
- iv) That the appellant should address us on the substantive appeal based on the amended notice of appeal found on pages 158 to 159 of the court record.
- v) That going by the grounds of appeal we found that most of these grounds were just argumentative and convoluted and that their drafting does not comply with

Order 111 rules 2, 3 and 4 of the Supreme Court of Appeal Rules. The parties were therefore specifically ordered to address the court on grounds of appeal number 4 and 5.

7. As we understand this appeal, the issues for determination can be crystalized as follows:

- i) Was additional default interest a penalty therefore not enforceable.
- ii) Was the additional default interest a genuine pre-estimate of the loss.
- iii) Was the collateral stipulation imposed upon the plaintiff to pay additional interest in default a penalty and in terrorem of the primary obligation to pay the principal obligation.

8. In arguing grounds 4 and 5 of appeal as amended, counsel for the appellant concentrated on pages 214 to 222 of the Court record. Having trashed most of the grounds of appeal, these were the only relevant pages in the appellant's skeleton arguments in relation to grounds of appeal 4 and 5.

9. The appellant's counsel submitted that the respondent's case was anchored on common law and so were the parties' arguments. The judgment also followed the same pattern. It was submitted that the judgment only made a cursory reference to statutory law.¹ There was however no reference to the constitution or its underlying values and principles.² It is counsel's submission that all law now enforced in Malawi and applied by the Courts derives its force from the constitution.³ That any law inconsistent with the constitution is invalid.⁴ This includes the common law of contract, which is subject to the supreme law of the constitution. Counsel emphasized that in the judgment under review, the Court below heavily relied on British law. That law has got no any constitutional foundation bearing any similarity with Malawi's constitutional law. From this constitutional approach, Malawi law both at statute and binding case law enjoin courts not to interfere with contracts without much circumspection. Counsel referred to the Consumer Protection Act which provides:

“Contracts governing financial transactions -----shall be interpreted, implemented and enforced (a) in good faith: (b) consistent with the instrument

¹ Consumer Protection Act (Cap 48:01) Laws of Malawi and Loans Recovery Act (Cap 3:06) Laws of Malawi

² Vol. 1 Laws of Malawi

³ See Sections 5 and 10 of the Constitution

⁴ See Section 5 of the Constitution

embodying the contract between the parties: and (c) in a manner consistent with laws governing or regulating financial transactions.⁵ Counsel referred to the case of **New Building Society vs Henry Mumba**⁶ as applied and confirmed in **NBS Bank Limited vs Sajid Jussab**,⁷ in which this court categorically endorsed the contractual autonomy principle saying:

“----- the courts should almost invariably be slow to intervene contrary to the express desire or wish of parties to a lawful agreement as to what should happen when certain specified events take place-----.”

It is therefore the appellant’s submission that there was no reason whatsoever for the Court below to re-write the parties’ agreement and take out any default interest.

10. Counsel went on to say that the judgment of the Court below set out to excuse the respondent from his contractual responsibility on the basis of the penalty rule as developed in England.⁸ Reference was also made to the case of **Cavendish Square Holding BV v Tatal El Makdessi and ParkingEye Limited v Beavis**⁹ in which the law in England regarding the rule against penalties was adequately discussed. In this case, the Supreme Court in England recorded that in relation to consumer contracts in England the matter was now effectively regulated by the Unfair Terms in Consumer Contracts Regulations. However, the rule on penalties still had a purpose to serve in relation to non-consumer contracts and it should not, be abolished. But equally the court felt that it should not be extended. Counsel submitted that the English Supreme Court then formulated the common law test for what constitutes an enforceable penalty clause. They held that the validity of such a clause turned on whether the party seeking to enforce the clause could claim a legitimate interest in the enforcement of the clause. Counsel referred to the five steps reformulated by the English Supreme Court as follows:

1. 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

⁵ See Section 28(2) Consumer Protection Act 2010

⁶ [2001-2002] MLR (Com) 243

⁷ [2020] MLR 337, 345

⁸ *Dunlop Pneumatic Tyre Co. v New Garage and Motor Co.* (1915) A.C. 79

⁹ [2015] UKSC 67

innocent party can have no proper interest in simply punishing the defaulter. His interest is in performance or in some appropriate alternative to performance.

2. There is a fundamental difference between a jurisdiction to review the fairness of a contract obligation and a jurisdiction to regulate a remedy for its breach. Leaving aside challenges going to the reality of consent, such as those based on fraud, duress or undue influence, the courts do not review the fairness of men's bargains either at law or equity. The penalty rule regulates only the remedies available for breach of a party's primary obligations, not the primary obligations themselves.

3. The application of the penalty rule may depend on how the relevant obligation is framed in the instrument, i.e. whether as a conditional primary obligation or a secondary obligation providing a contractual alternative to damages at law. Thus, where a contract contains an obligation on one party to perform an act. And also provides that, if he does not perform it, he will pay the other party a specified sum is a secondary obligation which is capable of being a penalty; but if the contract does not impose (expressly or impliedly) an obligation to perform the act, but simply provides that, if one party does not perform, he will pay the other party a specified sum. The obligation to pay the specified sum is a conditional primary obligation and cannot be a penalty.

4. The test based "deterrence" or "genuine pre-estimate of loss" or even the "commercial purpose clause" concept have been adjudged unhelpful. The real question whether a contractual provision is challenged as a penalty is whether it is penal, not whether it is a pre-estimate of loss. These are not natural opposites or mutually exclusive.

5. The question whether a damage clause is a penalty falls to be decided as a matter of construction as at the time that it is agreed. This is because it depends on the character of the provision, not the circumstances on which it falls to be enforced (emphasis is ours).

11. Having laid down the fundamental principles as formulated in the celebrated **Cavendish case**¹⁰, counsel for the appellant went to town dismantling the decision of the Court below. In relation to grounds 4 and 5 of appeal, counsel submitted that if the true test were to be applied, there is still no reason on the evidence why clause 8.2 would be adjudged as penalty under English Common law. This is so because the respondent's main obligation under the facilities is to pay back the money that

¹⁰ Supra

he had borrowed and to do so with interest. That was the respondent's primary obligation. The payment of default interest rate at the floating rate of the Bank's prime lending rate in effect from time to time increased by 10% is the same obligation to pay interest but adjusted as a result of default. It was submitted that clause 8.2 is a conditional obligation and cannot be a penalty. The condition being the default therefore it is not a secondary obligation.

12. On the issue of errors concerning the award of interest, the appellant's counsel submitted that in the Court below, the respondent claimed an order requiring the appellant to repay the respondent the total of MK56,864.90 being the penalty interest charged by the appellant together with interest at 1% above the appellant's lending rates from the date each component of the sum of Mk56,864.90 was charged to the date of payment. It is submitted that there was no basis for, or let alone, evidence supporting any basis for claiming interest. That the respondent should have clearly indicated the basis or ground upon which interest was being claimed on that specific rate. That interest must be strictly proved. The parties' agreement does not at all contain any clause where the Bank is required to refund any money. Counsel for the appellant submitted that the judgment from the Court below does not discuss anything about this interest and it came as a surprise how this award came about. In conclusion, the Court below erred in awarding this interest of 1% it was submitted.

13. In arguing their case the respondent's counsel submitted that in their contract agreement, the parties called the additional interest paid by the respondent a "penalty" or "penalties" as shown on pages 23, 28, 29, 32, 34, 49 of the court record. It was the appellant's duty to show in the court below that despite the fact that the parties had called the additional sums a penalty, the said sums were "nevertheless damages". The appellant made no effort of any kind to show this. The most that the appellant sought to show was that the practice of charging additional sums was prevalent amongst all banks. That does not however amount in showing that what has been referred to as a penalty is nevertheless damages. Counsel for the respondent further submitted that the fact that it is common practice amongst banks to charge additional interest in instances of default is neither here nor there. Counsel referred to the case of **National Bank of Malawi v Lilongwe Gas Company Limited**¹¹ where Katsala J as he then was said:

"I am not persuaded by the suggestion and or argument that since it is the practice in the banking industry to charge penalty interest when a borrower defaults

¹¹ Commercial Case No. 165 of 2016 (unreported) at page 8.

on agreed instalments, the 5% (or is it 10%?) penalty charge by the plaintiff must be allowed-----I find that the charging of penalty interest by the plaintiff is wrongful.”

And at page 9

“Thus I am in no doubt that the provision is penal. The argument that it is the practice in the banking industry to levy such penalties on borrowers who default on their loan repayments in my view, does not change the true nature of the provision. Commonsense does not confer legality. It remains penal, and as such, it is frowned by the courts.”

14. Counsel submitted that the parties in this case, by their correspondence, revealed that they meant the additional sums to be paid as penalty.

15. It is also the respondent's submission that in this case, there was adequate security for the loan therefore there was no ultimate risk of repayment. Adequate security for the loans here was given viz: two charges over the respondent's properties and irrevocable assignments of proceeds. In the case of the first loan, by a contract of assignment the Japanese International Cooperation Systems (JICS) bound themselves to pay Mk163,200,200.00 directly to the appellant. In the case of the second contract the undertaking to pay was made by the Malawi Government. The loan was not even disbursed to the respondent but directly to the respondent's suppliers. Thus there was absolutely no risk that the money would not be repaid. Where there was default normal interest continued to accrue. The additional 10% could not have been a genuine pre-estimate of damage.

16. We have received submissions and have been referred to many decided cases both from England and Australia. There has also been cited a lot of case law from our jurisdiction. It is imperative and important to note that most of the cases referred to from England and Australia are merely persuasive. They are not binding on the court. We now proceed to determine the issues raised in this matter. Suffice to say that out of the 11 (eleven) grounds of appeal, only two grounds that is grounds 4 and 5 stood the test.

17. We have looked at the facts of this case. First, the appellant agreed with the respondent to lend money to the respondent. The agreement included a charge of interest and to be specific, it was put at 44% comprising 39% per annum plus a margin of 5%. The parties further agreed that in the event of any default in the payments of the loan, an additional 10% interest described as 'Penalty Interest'

would be levied on the arrears. Therefore, the primary obligation is to pay the money borrowed with interest which is usually compounded.

18. In our view, the penalty rule does not put a secondary obligation on top of the primary obligation. We are mindful of the fact that any default indeed comes with a cost, however the cost should be the reasonable estimation of the loss. Going through the documents submitted by the appellant in the form of affidavits, the appellant was saying that this was not a penalty but estimated loss. It is however very clear from the court record that the appellant did not even state what loss they had incurred or would be incurred by them. Nonetheless, when a bank gives a loan it already takes into account the risks which include the possibility of a default. In other words, now the appellant is asking more on top of what they were already asking for.

19. For avoidance of any deliberate misunderstanding, we are saying that there will be circumstances warranting penalty interests but the lender has to demonstrate that this was an estimated loss. In this case before us, the appellant was not able to demonstrate that this was the estimation of the loss. As the appellant was giving out the loan to the respondent, if the appellant thought on top of what they had calculated there will be more loss the appellant need to demonstrate. The appellant should have shown that they have suffered the loss. They should not take advantage of the default. The appellant could only trigger the penalty rule so long as it is justified.

20. On the issue of judgment interest, the Court below is given jurisdiction by section 11(a) (v) of the Courts Act which empowers the high Court to direct interest to be paid on debts including judgment debts, or on sums found due on taking accounts between parties or on sums found due and unpaid by receiver or other persons liable to account to the High Court. Section 65 of the Courts Act provides that every judgment in civil proceedings shall carry interest at the rate of five per centum per annum or such other rate as may be prescribed. In the case of **Standard Bank and Another vs ML Luka and Others**¹² where the matter was concerning interest on judgment sum, in that case the Court stated that compound interest awarded is the discretion of the trial judge and it is not for the appeal Court to interfere.

21. The last issue relates to collection charges. The Courts always grant the collection charges at 15% as per Table 6 of the Scale and Minimum Charges under the Legal Education and Legal Practitioners Act. The appellants did not even argue this issue.

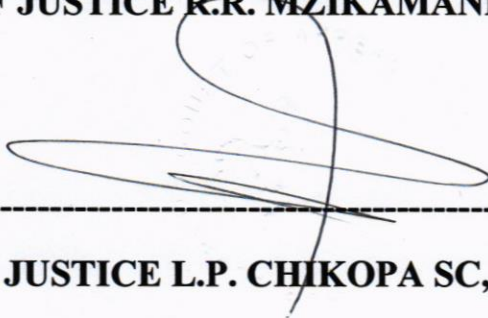
¹² [2014] MLS 323 (SCA)

22. We therefore unanimously find that there is no merit in this appeal and we dismiss it with costs awarded to the respondent.

DELIVERED this 12th day of March, 2024 at Blantyre.



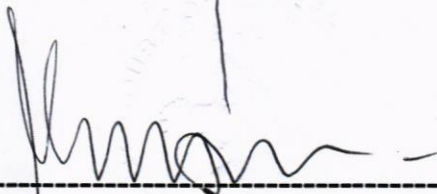
HON. CHIEF JUSTICE R.R. MZIKAMANDA SC, JA



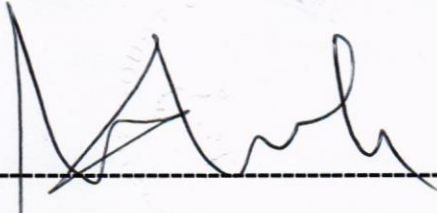
HON. JUSTICE L.P. CHIKOPA SC, JA



HON. JUSTICE F.E. KAPANDA SC, JA



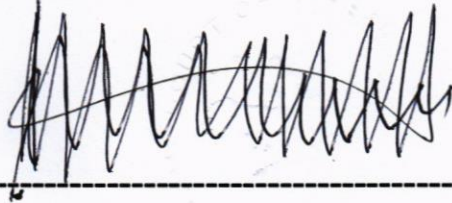
HON. JUSTICE H.S.B. POTANI JA



HON. JUSTICE J. KATSALA JA



HON. JUSTICE I.C. KAMANGA JA



HON. JUSTICE M.C.C. MKANDAWIRE JA