Supreme Court

New South Wales

Case Name:	Yang Bai v Watson Elite Pty Ltd
Medium Neutral Citation:	[2022] NSWSC 318
Hearing Date(s):	28 February 2022
Date of Orders:	23 March 2022
Decision Date:	23 March 2022
Jurisdiction:	Equity
Before:	Darke J
Decision:	Plaintiff entitled to judgment against second defendant but fails against third defendant. Funds in Court to be paid out to third defendant.
Catchwords:	REAL PROPERTY – securities – rights of a subsequent encumbrancer as against a prior encumbrancer – rights to enforce rights and equities of mortgagor against mortgagee – where plaintiff held an equitable charge over the property – where defendant held a registered mortgage over the property – whether the principle that a subsequent mortgagee can enforce the mortgagor's rights or equities against a prior mortgagee applies in the case of an equitable charge and a registered mortgage – plaintiff held to have standing to enforce mortgagor's rights and equities against the defendant MORTGAGES – equity of redemption – clogs on the equity of redemption – where mortgage contained an option for the mortgagee to purchase the mortgaged property following failure of mortgagor to repay – whether the option to purchase constituted a clog on the mortgagor's equity of redemption – whether the option to purchase was penal in nature – whether the option to purchase was unfair and unconscionable

Legislation Cited:	Real Property Act 1900 (NSW), s 74O, Div 3, Pt 7
Cases Cited:	Bonanno v Finamore [2021] NSWSC 1558 Chang v Registrar of Titles (1976) 137 CLR 177 G & C Kreglinger v New Patagonia Meat & Cold Storage Company Ltd [1914] AC 25 Golden Mile Property Investments Pty Ltd (in liq) v Cudgegong Australia Pty Ltd (2015) 89 NSWLR 237; [2015] NSWCA 100 King Investment Solutions Pty Ltd v Hussain (2005) 13 BPR 25,077; [2005] NSWSC 1076 Lift Capital Partners Pty Ltd (in liq) v Merrill Lynch International (2009) 73 NSWLR 404; [2009] NSWSC 7 Lysaght v Edwards (1876) 2 Ch D 499 Mainland v Upjohn (1889) 41 Ch D 126 Melbourne Banking Corporation v Brougham (1882) 7 App Cas 307 Paciocco v Australia and New Zealand Banking Group Ltd (2016) 258 CLR 525; [2016] HCA 28 Re Funds in Court; Application of Mango Credit Pty Ltd [2016] NSWSC 199 Re Modular Design Group Pty Ltd (Receiver and Manager Appointed) (in liq) (1994) 35 NSWLR 96 Sam Management Services (Aust) Pty Ltd v Bank of Western Australia Ltd [2009] NSWCA 320 Sun North Investments Pty Ltd v Dale [2014] 1 Qd R 369; [2013] QSC 44 Van Den Bosch v Australian Provincial Assurance Association Ltd (1968) 88 WN (Pt 1) (NSW) 357 Wallace v Evershed [1899] 1 Ch 891 Westfield Holdings Ltd v Australian Capital Television Pty Ltd (1992) 32 NSWLR 194 Westpac Banking Corporation v Daydream Island Pty Ltd [1985] 2 Qd R 330
Category:	Principal judgment
Parties:	Yang Bai (Plaintiff) Watson Elite Pty Ltd (First Defendant) Liangjie Chen (Second Defendant) Brick International Pty Ltd (Third Defendant)
Representation:	Counsel: Mr D Edney (Plaintiff) Mr A J Macauley and Mr S J Murray (Third Defendant)

	Solicitors: Longton Legal (Plaintiff) Summit Legal (Second Defendant) J C Legal Practice (Third Defendant)
File Number(s):	2020/349005
Publication Restriction:	None

JUDGMENT

Introduction

1 The plaintiff, Mr Bai, sues for relief against three defendants arising from dealings concerning certain land in Thornleigh. The land was the subject of a residential development being undertaken by the first defendant, Watson Elite Pty Ltd ("Watson Elite"). The second defendant, Mr Liangjie Chen, is a director of Watson Elite. The development involved a strata subdivision of the land.

2 On 20 January 2017, Mr Bai's wife entered into an "off the plan" contract with Watson Elite to purchase Lot 15 in the proposed strata plan for a price of $998,200. The contract provided for payment of a 10% deposit of $99,820 on the contract date, and for an instalment of $889,380 (being the remaining 90% of the purchase price) within 90 business days of the contract date. These payments were made on about 19 January 2017 and 10 May 2017 respectively. Accordingly, the entire purchase price was paid. The contract further provided for the amounts to be released to Watson Elite as directed and when required by it for the purposes of the development.

3 On 16 May 2017, Mr Bai's wife and Watson Elite entered into a Deed of Rescission and Release which provided for their contract to be rescinded in consideration of Watson Elite and Mr Bai entering into a contract for sale on the same terms. The Deed contained a direction to Watson Elite's solicitors to apply to the new contract the deposit that had been paid and released under the first contract. The Deed is silent as to the fate of the remaining 90% of the purchase price that had been paid under the first contract.

4 Mr Bai and Watson Elite indeed entered into a contract for sale on 16 May 2017 on the same terms as the earlier contract.

5 The relevant strata plan, SP99616, was registered on 10 February 2020. Lot 15 in SP99616 ("Lot 15") became the identified subject matter of the contract for sale between Mr Bai and Watson Elite. I note in passing that upon the registration of the strata plan it was open to Mr Bai, under the terms of the contract for sale, to lodge a caveat. However, he did not do so.

6 On 26 March 2020, Watson Elite's solicitors sent a letter to Mr Bai's solicitors that enclosed a copy of the registered strata plan and a copy of an Occupation Certificate. Under the terms of the contract, completion was thus due to take place 14 days later. The terms of the letter from Watson Elite's solicitors suggested that completion would take place accordingly. It seems that Mr Bai's solicitors made attempts to contact Watson Elite's solicitors to have settlement arrangements made, but these efforts were to no avail.

7 On about 19 May 2020, Watson Elite entered into a Loan Agreement with LX & HZ Pty Ltd. The agreement provided for a loan of a principal sum of $600,000 to be repaid in two weeks. The interest rate was expressed to be 3% per month. Watson Elite also granted a mortgage of Lot 15 to LX & HZ Pty Ltd. That mortgage (AQ109465) was registered on 19 May 2020 following the registration of a discharge of an existing mortgage.

8 On 30 June 2020, Watson Elite entered into a Loan Agreement with the third defendant, Brick International Pty Ltd ("Brick"). The agreement provided for a loan of a principal sum of $700,000 to be repaid by 30 July 2020 with "time strictly of the essence". The interest rate was expressed to be 1% per month. Watson Elite also granted a mortgage of Lot 15 to Brick. That mortgage (AQ215751) was registered on 3 July 2020 following the registration of a discharge of the LX & HZ Pty Ltd mortgage.

9 It should be noted that the Loan Agreement also contained an option for Brick to purchase Lot 15 for a price of $700,000. The option was expressed to be exercisable by Brick at any time on or within 30 business days after 31 July 2020. Mr Bai seeks to impugn this option on the basis that it constitutes a clog on the equity of redemption.

10 Watson Elite failed to repay the loan from Brick by 30 July 2020 as required.

11 On 31 July 2020, Brick exercised the option to purchase, and took steps to have a transfer of Lot 15 from Watson Elite to itself registered on that same day, following the registration of a discharge of Brick's mortgage.

12 On 1 August 2020, Watson Elite lodged a caveat (AQ289613) against the title to Lot 15, claiming an interest in fee simple on the basis that the transfer to Brick was said to have been "unauthorised". Brick, as the registered proprietor of Lot 15, later took steps to have a lapsing notice served in relation to the caveat. The caveat lapsed on about 23 October 2020.

13 On 23 October 2020, Mr Bai lodged his own caveat against the title to Lot 15 (AQ494273). Mr Bai claimed to have a charge over the land by virtue of a contract for sale dated 16 May 2017. The caveat erroneously refers to a contract between Mr Bai and Brick. Presumably, Mr Bai intended to base his claim on his contract for sale with Watson Elite. By cl 2.8 of that contract, a charge is created in favour of the purchaser "until termination by the vendor or completion" in respect of any deposit or balance of the price that is "paid before completion to the vendor or as the vendor directs". Mr Bai would seem at least to have had a charge over the land in respect of the deposit that had been released to Watson Elite under the first contract and thereafter applied to Mr Bai's contract.

14 It appears that Mr Bai lodged his caveat as part of certain dealings he was then having with Watson Elite and its director, Mr Liangjie Chen. On 22 October 2020 Watson Elite and Mr Bai entered into a Deed of Indemnity whereby Watson Elite agreed to indemnify Mr Bai in respect of the lodgement of his caveat. On the same day, Mr Liangjie Chen gave a warranty to Mr Bai that Watson Elite would have sufficient funds within 14 days to fulfill its loan obligations to Brick and would cause that loan to be repaid in full. Mr Bai deposed that Watson Elite had claimed to him that, if it repaid that debt, Brick would return the property and Watson Elite would thereafter transfer it to Mr Bai. Mr Bai sues Mr Liangjie Chen for breach of the warranty.

15 Brick, as the registered proprietor of Lot 15, caused a lapsing notice to be served in respect of Mr Bai's caveat. This prompted Mr Bai to commence these proceedings on 9 December 2020.

16 On 17 December 2020, various orders were made by consent, and the Court noted various matters. The orders provided, inter alia, for Mr Bai to have leave under s 74O of the *Real Property Act 1900* (NSW) to lodge a further caveat over Lot 15 claiming the same interest as was claimed in his earlier caveat which, it seems, had lapsed. The Court noted an agreement between Mr Bai and Brick that Lot 15 would be sold by Brick, with the proceeds of sale after the payment of certain expenses, charges and amounts that had formerly been secured by Brick's mortgage, to be paid into Court pending further order or agreement between Mr Bai and Brick.

17 Lot 15 was sold on 6 February 2021 to third parties for a price of $900,000. Following settlement of the contract, an amount of $104,326.33 was paid into Court on 23 March 2021. Those funds in Court are the subject of the competing claims of Mr Bai and Brick.

18 In the meantime, on 25 February 2021, Mr Bai served a Notice of Termination in respect of the contract for sale entered into on 16 May 2017. The notice stated that Watson Elite had failed to comply with a Notice to Complete dated 5 February 2021, and that the contract was thereby terminated for breach.

19 On 25 March 2021, a default judgment was entered in favour of Mr Bai against Watson Elite in the sum of $1,111,999.50. The judgment remains unsatisfied. Watson Elite has since been placed into liquidation.

20 It remains for the Court to determine Mr Bai's claims against Mr Liangjie Chen and Brick.

The claim against Brick

21 It is convenient to deal first with Mr Bai's claim against Brick. The primary focus of the claim is upon the $104,326.33 that was paid into Court following the sale of Lot 15. Whilst Mr Bai accepts that Brick is entitled to recover all amounts properly due to it under its mortgage, he contends that Brick is not otherwise

entitled to the proceeds of the sale of the property. Mr Bai claims that he is entitled to such proceeds.

22 The foundation of this claim is a contention that the option to purchase contained in Brick's mortgage is void as a clog on the equity of redemption, or alternatively, void because it is unfair and unconscionable. Mr Bai further contends that, in the circumstances, Brick's ascension to registered proprietorship of Lot 15, following its exercise of the option to purchase, did not confer an indefeasible title upon Brick. In this regard, Mr Bai sought to invoke an *in personam* claim against Brick rather than the fraud exception to indefeasibility.

23 Counsel for Mr Bai accepted that, in making these claims, he was seeking to enforce rights or equities available to Watson Elite (in its capacity as mortgagor) as against Brick (in its capacity as mortgagee). Brick, however, challenged Mr Bai's standing to assert such rights or equities.

24 In response to that challenge, Mr Bai submitted that his standing arose from his status:

(a) as the equitable owner of the property pursuant to the contract for sale under which the entire purchase price had been paid; and/or

(b) as an equitable chargee pursuant to cl 2.8 of the contract for sale.

25 Mr Bai submitted that, as a "subsequent encumbrancer", he is entitled to an accounting from a prior (that is, higher ranking) encumbrancer (such as Brick), and can enforce all equities available to the mortgagor (Watson Elite). Reference was made to the decision of McPherson J in *Westpac Banking Corporation v Daydream Island Pty Ltd* [1985] 2 Qd R 330 at 331, where his Honour said:

> It is true that a second mortgagee may depend for his interest in the proceeds upon the existence of a surplus; but as assignee of the equity of redemption he is in general entitled to enforce against the first mortgagee all rights available to the mortgagor himself. Ancient but respectable authority for this is to be found in *Coppring v. Cook* (1684) 1 Vern. 270; 23 E.R. 463; see also *Melbourne Banking Corporation v. Brougham* (1882) 7 App.Cas. 307, 311; *Mainland v. Upjohn* (1889) 41 Ch.D. 126, 136 *per* Kay J.; *Coote's Law of Mortgages*, 9th ed. (1927) vol. 2, pp. 828-829; Ashburner: *Treatise on Mortgages*, p. 295.

26 Brick submitted that, insofar as Mr Bai rested his standing on his status as the beneficial owner of the property, that status was lost once Mr Bai terminated the contract for Watson Elite's breach. It was put, correctly in my opinion, that once termination occurred Mr Bai's inability to obtain specific performance of the contract precludes a finding that he has an equitable interest (as the beneficiary of a constructive trust sub modo) in Watson Elite's "equity of redemption" (see *Lysaght v Edwards* (1876) 2 Ch D 499 at 506-9 per Jessel MR; *Chang v Registrar of Titles* (1976) 137 CLR 177 at 184 per Mason J; *Golden Mile Property Investments Pty Ltd (in liq) v Cudgegong Australia Pty Ltd* (2015) 89 NSWLR 237; [2015] NSWCA 100 at [98]-[99] per Emmett JA).

27 In relation to Mr Bai's submission that he was a "subsequent encumbrancer", Brick submitted that Mr Bai was not in the position of "an assignee of the equity of redemption" as referred to by McPherson J in the passage cited above, and as illustrated in *Melbourne Banking Corporation v Brougham* (1882) 7 App Cas 307 at 311. Brick then referred to *Mainland v Upjohn* (1889) 41 Ch D 126 at 136 and submitted that Mr Bai is not in any event seeking to vindicate the equity of redemption by redeeming. It was further submitted that Mr Bai was not seeking to have the contract for sale (which arose upon Brick's exercise of the option), or the subsequent transfer to Brick, set aside.

28 I agree that Mr Bai, as the holder of an equitable charge under cl 2.8 of his contract with Watson Elite, is not in the position of an assignee of the equity of redemption. Further, as Mr Bai's charge is not a mortgage (or even a charge) under Division 3 of Part 7 of the *Real Property Act*, he is unable to avail himself of the powers those provisions confer upon mortgagees and chargees, including powers to sell, take possession, or apply for an order for foreclosure. As an equitable chargee, Mr Bai has no similar rights under the general law (see *King Investment Solutions Pty Ltd v Hussain* (2005) 13 BPR 25,077; [2005] NSWSC 1076 at [50]-[51]). The remedies available to an equitable chargee such as Mr Bai are principally the obtaining of orders from the Court for the sale of the charged property, or the appointment of a receiver.

29 However, Mr Bai claims an interest in the land that was the subject of Brick's mortgage. He claims his interest through or under the mortgagor, Watson Elite.

There is authority that a person in that position has an equitable right to redeem (see *Van Den Bosch v Australian Provincial Assurance Association Ltd* (1968) 88 WN (Pt. 1) (NSW) 357 at 360-3; see also *Wallace v Evershed* [1899] 1 Ch 891). Mr Bai is not in these proceedings formally seeking to redeem Brick's mortgage. Rather, he is seeking, in substance, an account following the sale of the mortgaged property. Nevertheless, it seems to me that Mr Bai has a sufficient interest to stand in the shoes of Watson Elite to assert rights or equities available to Watson Elite as mortgagor against Brick as mortgagee.

30 I therefore proceed on the basis that Mr Bai has standing to seek to impugn the option to purchase contained in Brick's mortgage, and impeach Brick's title as registered proprietor.

31 In dealing with those claims, the first question to consider is whether the option to purchase contained in Brick's mortgage could be impugned on the ground that it amounts to an impermissible collateral advantage. A conventional starting point, in considering the principles applicable in this area, is the speech of Lord Parker in *G & C Kreglinger v New Patagonia Meat & Cold Storage Company Ltd* [1914] AC 25 where his Lordship said, at 61:

> …there is now no rule in equity which precludes a mortgagee, whether the mortgage be made upon the occasion of a loan or otherwise, from stipulating for any collateral advantage, provided such collateral advantage is not either (1) unfair and unconscionable, or (2) in the nature of a penalty clogging the equity of redemption, or (3) inconsistent with or repugnant to the contractual and equitable right to redeem.

32 Mr Bai submitted that the option fell within either or both of the second or third propositions above. He submitted that, in those circumstances, it was not necessary to establish that the option to purchase was relevantly unfair and unconscionable. It was recognised that there is a line of authority in New South Wales, arising from the judgment of Young J (as his Honour then was) in *Westfield Holdings Ltd v Australian Capital Television Pty Ltd* (1992) 32 NSWLR 194 ("*Westfield Holdings*"), that suggests that it is necessary to show that the impugned stipulation is unfair and unconscionable. In that case, Young J stated (in *obiter*) at 202-3:

> There does not appear to be any commercial reason why, in 1992, the court should invalidate any transaction merely because a mortgagee obtains a collateral advantage or seeks to purchase a mortgage property. Quite

> obviously equity must intervene if there is unconscionable conduct. Again equity must intervene in the classic case where it can see that a necessitous borrower is not, truly speaking, a free borrower.
>
> In my view, in 1992, the rule only applies where the mortgagee obtains a collateral advantage which in all the circumstances is either unfair or unconscionable. It may be that the court presumes from the mere fact of a collateral advantage that the transaction is unconscionable unless there is evidence to the contrary, but the principle does not extend to invalidate automatically cases in which the mortgagee has obtained the right to purchase the whole or part of the mortgaged property in certain circumstances or has obtained a collateral advantage where the circumstances show that there has been no unfairness or unconscionable conduct.

33 That statement has been approved in a number of later decisions of this Court, including *Re Modular Design Group Pty Ltd (Receiver and Manager Appointed) (in liq)* (1994) 35 NSWLR 96 at 103, *Lift Capital Partners Pty Ltd (in liq) v Merrill Lynch International* (2009) 73 NSWLR 404; [2009] NSWSC 7 at [136]-[137], and *Re Funds in Court; Application of Mango Credit Pty Ltd* [2016] NSWSC 199 at [102]-[106].

34 Against that, Mr Bai submitted that these statements were mere *dicta*, and that the Court should prefer the older established principles concerning clogs on the equity of redemption as stated by Lord Parker, and as applied in the Supreme Court of Queensland (Henry J) in *Sun North Investments Pty Ltd v Dale* [2014] 1 Qd R 369; [2013] QSC 44 at [73]-[87] and [100]-[116].

35 This issue was recently the subject of thorough discussion by Robb J in *Bonanno v Finamore* [2021] NSWSC 1558. His Honour considered in detail the authorities concerning the principles as stated by Lord Parker in the passage cited above. His Honour described Lord Parker's formulation as "the modern version of the old doctrine" that prohibited clogs on a mortgagor's equity of redemption (see at [242]). At [282] Robb J stated that caution is warranted in making further adjustments to the old doctrine, noting that if what Young J said in *Westfield Holdings* is accepted, propositions (2) and (3) would be abandoned, with only proposition (1) remaining in their stead.

36 In relation to proposition (2), Robb J expressed some doubt about whether it would be appropriate to vary proposition (2) in any way that would interfere with the application of the modern doctrine of penalties (see at [294]).

37 In relation to proposition (3), Robb J stated at [343] that he accepted the conclusion of Young J in *Westfield Holdings* and the judges who have since followed it, that legal and commercial changes have occurred that call for a revision of Lord Parker's proposition (3). His Honour continued at [344]-[345]:

> 344 I do not accept that Lord Parker's Proposition (3) should be replaced solely by his Proposition (1), at least by means of judgments at first instance. I have already explained why I do not think that the circumstances of the present case justify any interference with Proposition (2). The change that I consider is justified involves a significant but focused adjustment of the nature of the transactions that will engage Proposition (3), and a removal of those transactions so that they fall within the operation of Proposition (1). In essence, that change would be to permit the parties to include in the one transaction both a mortgage and an option to purchase, where the option gives the mortgagee a right to require the mortgagor to enter into a contract to sell the property to the mortgagee for a proper price that is in an appropriate way referable to its value. There should no longer be any absolute exclusion of the right of parties to a mortgage, at the same time as the mortgage is granted, to freely enter into an option to sell the property on just terms. What the law permits the parties to do a day after the mortgage is granted, should be permitted to be done at the same time as the mortgage.
>
> 345 This change would have the effect of adding to the commercial collateral advantages that were upheld in *Kreglinger* an advantage, created by the free decision of the mortgagor, to sell the property for a real price considered by the mortgagor to be adequate. It would reverse the currently untenable presumption that all mortgagors are "necessitous men" liable to "submit to any terms that the crafty may impose upon them". The change would return to mortgagors their right to decide how to deal with their property without the imposition of a rule, to use Lord Macnaghten's words in *Samuel*, that is "founded on sentiment rather than on principle". It would accord with what I think is the modern lawyer's conception that repugnancy to the terms of an agreement should depend on what the agreement actually is, and that an agreement to reconvey (where still relevant) does not have some inviolable significance so that any genuine, contrary agreement between the parties is necessarily repugnant.

38 Whilst maintaining that the older, absolute rule, as applied in *Sun North Investments Pty Ltd v Dale* (supra) should be preferred, counsel for Mr Bai conceded that it was open to me to follow the approach advanced by Robb J. Counsel for Brick submitted that, in practical terms, this approach was not much different to the principle espoused in *Westfield Holdings*. It was submitted that so long as the property was to be acquired for a "proper price" or on "just terms" an option to purchase contained in a mortgage will not constitute an impermissible clog on the equity of redemption. It was further submitted that the acceptance of the principle espoused in *Westfield Holdings* by Barrett J in *Lift Capital Partners Pty Ltd v Merrill Lynch International* (supra)

was not mere *obiter dictum*, as the case was decided on the basis of the principle. Reference was also made to the decision of the Court of Appeal in *Sam Management Services (Aust) Pty Ltd v Bank of Western Australia Ltd* [2009] NSWCA 320 at [59]-[60] where there is apparent endorsement of the principle that unconscionable conduct is required before an agreement can be impugned on the ground that the mortgagor's right to redeem is clogged (see *Re Funds in Court; Application of Mango Credit Pty Ltd* (supra) at [105]).

39 It is desirable at this point to refer in some more detail to the circumstances in which the mortgage to Brick, which contains the option to purchase, was entered into.

40 Mr Hao Chen, a director of Brick, deposed that on about 29 June 2020 he was contacted by a intermediary who stated that he acted for Watson Elite. Mr Chen (not to be confused with Mr Liangjie Chen, the second defendant) says that the intermediary advised him that Watson Elite required a short term loan of 1 month in order to refinance an existing loan which was secured over Lot 15. A property search was undertaken by Brick on 29 June 2020 which indicated that the only encumbrance over the property was a mortgage to LX & HZ Pty Ltd. Mr Chen deposed that he was not aware at that time of any interest claimed in the property by Mr Bai. Mr Chen refers in his affidavit to a valuation report dated 1 April 2020 concerning the building in which Lot 15 is located. His evidence in this regard is somewhat unclear, and the position was not clarified in cross-examination. It seems that the report was not obtained by Mr Chen until about late-October 2020, though the words of his affidavit imply that he may have seen it prior to instructing solicitors in relation to the proposed loan.

41 On 30 June 2020, shortly before 10:00am, Brick's solicitors sent draft loan documents to Watson Elite's solicitors for execution and return for a settlement to occur at 1:00pm on that day. The documents included a Loan Agreement and mortgage, as well as other documents including a Statutory Declaration of Borrower (in relation to the obtaining of legal advice), a Power of Attorney (from Watson Elite to Mr Chen), and a Client Authorisation Form (to authorise a representative to sign and lodge documents in respect of conveyancing transactions). The documents were returned to Brick's solicitors, duly executed

and without amendment, later on 30 June 2020. Settlement of the transaction appears to have occurred in the PEXA system at around 4:40pm on 30 June 2020.

42 Mr Chen deposed, in his second affidavit, that as at 30 June 2020 he was aware that Watson Elite was seeking a loan to repay another loan Watson Elite had been unable to pay and was in default. He further deposed:

(a) that he held the view that the COVID-19 pandemic, and the government policies that had been implemented in response to prevent the spread of the virus, had affected the Sydney property market, including by reducing demand from overseas persons for newly constructed units like Lot 15;

(b) that he was concerned about the state of the Sydney property market and was uncertain whether the value of newly constructed units would increase in the future or would diminish due to a decrease in demand from overseas purchasers and the potential adverse economic consequences arising from ongoing lockdowns;

(c) that he believed that there was a real risk that the value of newly constructed units like Lot 15 would decrease in the future and by a not insignificant amount, possibly up to 20%; and

(d) that in these circumstances he proposed the option to purchase because of the uncertainty surrounding the future value of the property, reasoning that if the value declined Brick would have the option of acquiring the property so as to hold it, potentially over the long term, with the hope that subsequent price appreciation would allow it to recover the total value of the advance as well as generate a return appropriate for the risk involved in the loan.

43 Mr Chen was cross-examined, but it was not put to him that he did not hold the views set out above, or that it was unreasonable to hold those views.

44 However, Mr Chen agreed in cross-examination that if the property market went up he (that is, Brick) could exercise the option to purchase and make a big profit. Similarly, he agreed that if the market rose in the 1 month term of the loan, he could get the property at a big discount to the market value. I note that these answers were given in response to questions that also referred to the market staying the same. Nevertheless, I would not take Mr Chen's answers as concessions to the effect that he understood that the purchase price under the option was well below the prevailing market value. It would be unfair to do so,

having regard to the problematic nature of the questions. If a concession to that effect had been sought, the proposition should have been put plainly to Mr Chen.

45 It was put to Mr Chen that he understood that Watson Elite needed to proceed with the loan, and did not have a choice. Mr Chen did not assent to the proposition, saying that he could not remember exactly what happened.

46 As previously noted, the Loan Agreement provided for a loan of a principal sum of $700,000 to be repaid by 30 July 2020 with time being of the essence. The interest rate was 1% per month which, it should be noted, is considerably less than the interest rate on the existing LX & HZ Pty Ltd loan. The option to purchase is contained in cl 11 of the agreement in the following terms:

> 11. OPTION TO PURCHASE
>
> 11.1. In consideration of the Lender entering into this Agreement and payment of the Option Fee by the Lender which the Borrower acknowledges, the Borrower grants the Lender for valuable consideration the Option to purchase the Property for the Option Price.
>
> 11.2. The Option set out in this clause may be exercised by the Lender at any time on or within 30 business days after the Exercise Date at his sole and absolute discretion.
>
> 11.3. The Borrower agrees that he shall accept payment of the Option Price by the Lender by way of off-setting as against any amounts then due and owing to the Lender by the Borrower as at the date of completion of the Option Contract.
>
> 11.4. The Lender shall exercise the Option by providing to the Borrower the Notice of Exercise of Option hereto annexed and a copy of the front page of the Contract for the sale and purchase of land duly executed and dated by the Lender.
>
> 11.5. A contract for the sale and purchase of land in respect of the Property shall be deemed to be immediately in force upon the exercise of the Option by the Lender.
>
> 11.6. The Option Contract shall enclose the terms as annexed to this Agreement.
>
> 11.7. Subject to, and only upon, repayment of all amounts due and payable under this Agreement and the discharge of any and all of the Borrower and Guarantor's obligations under this Agreement on or before the Loan Repayment Date and in this respect time shall be strictly of the essence, the Borrower shall be entitled to, and the Lender agrees, to rescind the grant of the Option.

The Option Fee was defined as $1.00. The Option Price was defined as $700,000. The Exercise Date was defined as 31 July 2020. That date is one

day after the date the loan was required to be repaid in accordance with the contract.

47 The option was therefore not capable of interfering with Watson Elite's contractual right to repay the loan and redeem the mortgage. However, it was plainly capable of precluding Watson Elite's equitable right to repay the loan and redeem the mortgage after the passing of the date the loan was required to be repaid under the contract. In these circumstances, the option to purchase may be regarded as a collateral advantage that is inconsistent with or repugnant to the equitable right to redeem, so as to fall within Lord Parker's proposition (3).

48 On the approach espoused by Robb J in *Bonnano v Finamore* (supra), it is permissible to include in the one transaction both a mortgage and an option to purchase if the option is freely entered into on just terms; for a proper price that is "a real price considered by the mortgagor to be adequate"; or a price that is "in an appropriate way referable to its value" (see at [344] – [345]).

49 Mr Bai submitted that there is no suggestion that the option was the subject of negotiation between the parties, nor that the option price reflected the true value of Lot 15. It was submitted that its own terms show that it was given for no consideration other than the provision of the loan by Brick. Mr Bai submitted that it served as nothing more than a clog (and indeed a penalty), and was not needed to protect Brick's position if there was a slump in the market. It was submitted that if there was no slump in the market, the option would provide a windfall gain to Brick. Mr Bai also submitted that Mr Chen had accepted that the option price of $700,000 was understood to be a material discount to the value of the property. However, for the reasons set out earlier, I do not accept that Mr Chen made such a concession.

50 I would add that even if it is assumed that Mr Chen had seen the valuation report dated 1 April 2020 (which had been prepared on the instructions of Watson Elite) it was not a valuation of Lot 15 itself. It was a valuation of a number of lots within the building that also contains Lot 15. Mr Chen stated in his affidavit that the report indicated that Lot 17, said to be similar to Lot 15, had a value of about $840,000. He also gave evidence, which was not

challenged, concerning his views of the property market. Those views were evidently informed at least in part by events after 1 April 2020, and included the belief that there was a real risk that values could decrease by up to 20%. On that basis, even if Mr Chen thought Lot 15 had a value of approximately $840,000 as late as 30 June 2020 (almost three months after the date of the report) he would have been concerned that the value may decrease to a level below the option price of $700,000.

51 Brick submitted that, in approaching this question, it is relevant to consider that Watson Elite was a sophisticated property developer that had completed a development involving numerous apartments, and was legally represented when it entered into the transaction with Brick. By reference to the valuation report dated 1 April 2020, Brick submitted that the terms of the option were not manifestly unreasonable or unconscionable, and the price could be regarded as a "proper price" bearing in mind the uncertain situation that prevailed in late June 2020. Brick further submitted that the option served a legitimate commercial purpose in that uncertain situation by giving it the opportunity (only exercisable within a 30 business day window) to acquire the property rather than proceed to sell it in a potentially volatile and depressed market.

52 In my opinion, the option to purchase, which forms part of the broader loan and mortgage transaction, should be regarded as an agreement freely entered into by the parties on just terms. Watson Elite was, as submitted by Brick, a property developer that had completed construction of the Thornleigh development. It should be taken to have been well placed to make an assessment of the value of Lot 15, albeit that there was clearly a degree of market uncertainty at the time. Watson Elite at least had the benefit of the valuation report of 1 April 2020. Moreover, it was represented by solicitors in the transaction. Its director signed a statutory declaration to the effect that the solicitors provided legal advice about the documents, including the Loan Agreement, and that the loan documents were freely and voluntarily entered into. No evidence has been adduced that would cast doubt on those declarations. The solicitors' advice would almost certainly have included advice about the option to purchase. The option is clearly referred to in the Schedule to the agreement, and its terms, including as to price, are manifest. Watson

Elite, with its knowledge of the development and its likely value, should be taken to have considered the price to be adequate in the circumstances. To my mind, the price can be properly regarded as a proper price that is appropriately referable to the value of Lot 15.

53 For the above reasons, adopting the approach favoured by Robb J in *Bonnano v Finamore* (supra), the option to purchase does not fall within Lord Parker's proposition (3) and is not to be impugned on that basis.

54 In view of the evidence, such as it is, going to the question of the value of Lot 15, and the evidence of Mr Chen concerning the uncertainty being experienced in late June 2020, I am also of the opinion that the option to purchase does not fall within Lord Parker's proposition (2). To the extent that the option might be regarded, in substance, as a stipulation collateral to the stipulation for repayment of the loan by 30 July 2020, I do not think that it is extravagant or unconscionable, or out of all proportion to the interests of Brick that were sought to be protected, such that it ought be characterised as a penalty (see *Paciocco v Australia and New Zealand Banking Group Ltd* (2016) 258 CLR 525; [2016] HCA 28 at [29] and [34]). It is not plainly excessive in nature in comparison with the particular interest sought to be protected by Brick, namely, recovery of the money lent if Watson Elite failed to repay as required by the contract. Nor can it be seen in the circumstances as a stipulation the only purpose of which is to punish Watson Elite (see *Paciocco v Australia and New Zealand Banking Group Ltd* (supra) at [158] and [164]), or as a provision that is distinctly punitive in character (see *Paciocco v Australia and New Zealand Banking Group Ltd* (supra) at [221]).

55 Based on Mr Chen's evidence set out above at [42], which as I have said was effectively unchallenged, I am unable to conclude that any loss that Watson Elite might suffer, or any concomitant gain that Brick might obtain, if the option were exercised, is so out of proportion to the interests of Brick sought to be protected that the option should be characterised as penal.

56 That leaves Lord Parker's proposition (1), and the line of authority arising from the judgment of Young J in *Westfield Holdings*, that a collateral advantage may be impugned if it is unfair and unconscionable.

57 Mr Bai submitted that the option to purchase, and its manner of exercise by Brick, was unfair and unconscionable. The particulars provided in respect of this allegation were to the effect:

(a) the option allowed Brick to instantly foreclose upon the mortgage and extinguish the equity of redemption upon any delay in repayment of the mortgage;

(b) the price to be notionally paid in respect of the property pursuant to the option was significantly less than the true value of the property;

(c) accordingly, the option operated to impose a penalty upon Watson Elite and give a significant windfall gain to Brick instantly upon any delay in repayment of the mortgage; and

(d) the option was not required to indicate any legitimate interest of Brick.

58 It was put in submissions that the option:

(a) was extracted from Watson Elite as an obviously desperate mortgagor;

(b) did not reflect any genuine assessment of the value of the property; and

(c) had little function other than to impose a penalty on Watson Elite and give Brick the opportunity for a windfall if, as was likely, there was any delay in payment.

59 It was further put that the option was not the subject of negotiations between the parties, one of whom was a clearly necessitous borrower, and thus at a great disadvantage. It was submitted that there was inherent unconscionability in an option which is “a pure forfeiture of the equity of redemption as distinct from a genuinely negotiated option”.

60 It is true that the terms of the option were not the subject of specific negotiation between the parties. The option was included in the draft transaction documents submitted by Brick’s solicitors to the solicitors for Watson Elite, and Watson Elite signified acceptance of all of the terms of the documents by executing them and having them promptly returned to Brick. I would also accept that as at 30 June 2020 Watson Elite was in need of finance. Its existing loan from LX & HZ Pty Ltd, which was secured by a registered mortgage over Lot 15, was due to be repaid. Nevertheless, I do not think that these matters themselves establish that the option was relevantly unfair and unconscionable.

No evidence was adduced as to Watson Elite's broader financial position. Nor was there any evidence of how Watson Elite assessed the transaction, including the option, having regard to that position and its commercial interests more generally. As I have already said, Watson Elite should be taken to be well placed to make an assessment of the value of Lot 15. In these circumstances, I do not think there is good reason to conclude that Watson Elite was not able to properly protect its interests in the transaction, even if it was under a degree of financial pressure due to the expiry of the LX & HZ Pty Ltd loan. Moreover, it cannot be concluded that Watson Elite entered into the transaction because it essentially had no other choice. Watson Elite had the benefit of legal advice and, after receiving that advice, it declared that it had freely and voluntarily entered into the loan documents. If it be the case that the mere existence of a collateral advantage gives rise to a presumption that the transaction is unconscionable unless there is evidence to the contrary, that is sufficient evidence to the contrary.

61 It is also true that the option, if exercised, would have the effect of extinguishing the equity of redemption. In that regard, I accept that there was the potential for Brick to acquire Lot 15 for a price less than its true value. The realisation of that potential would depend upon the value of the property at the time of the exercise of the option. Given the market uncertainty that existed on 30 June 2020 when the option was granted, and the absence of firm evidence of the value of Lot 15 as at that date, it is difficult to assess both the likelihood that Brick would profit if it exercised the option, and the likely extent of any such profit. As I have already said, even if it is assumed, based on the valuation of similar property as at 30 April 2020, that Lot 15 had a value in the order of $840,000 as at 30 June 2020, Mr Chen's evidence was that he believed there was a real risk that values may decrease by up to 20%. There was no evidence adduced as to how Watson Elite viewed the matter at that time. I would add that there was no direct evidence of the value of Lot 15 as at 31 July 2020 when Brick exercised the option, although it is known that in February 2021 Brick was able to sell the property for a price of $900,000. Given the uncertainty that existed in the market in June 2020, as referred to by Mr Chen in his evidence, I do not think it is open to the Court to come to a firm

conclusion as to the actual value of Lot 15 around that time, but I think it is likely, having regard to the 30 April 2020 valuation and the later sale, that it was worth no less than about $800,000 around that time.

62 I do not accept the submissions to the effect that the option was not required to vindicate any legitimate interest of Brick. Mr Chen explained the rationale for seeking the option. That evidence was effectively unchallenged, and I am prepared to accept it.

63 Further, it should be observed that it was not put to Mr Chen that the manner in which the option was entered into, or the later exercise of the option, involved any moral obloquy or moral deficiency on the part of Brick. At most, it was suggested to Mr Chen that he was aware that Brick might be able to obtain the property at a large discount, and that he understood that Watson Elite had no choice but to proceed with the loan from Brick. That evidence is referred to above at [44]-[45].

64 In my opinion, taking all of the circumstances into account, the option to purchase was not relevantly unfair and unconscionable. Brick became entitled to exercise the option on 31 July 2020 as Watson Elite had not repaid all amounts due and payable under the Loan Agreement by the Loan Repayment Date of 30 July 2020. The exercise by Brick of its legal right in this regard did not in my view amount to unconscientious conduct.

65 Neither did Brick act unconscientiously in the manner in which it exercised the right. Mr Bai complained that the exercise of the option involved the use of the power of attorney under the Loan Agreement to amend the date on the contract for sale so as to facilitate completion of the sale on 31 July 2020. That merely accelerated the time within which Brick was able to become the registered proprietor of Lot 15 following a valid exercise of the option to purchase. Mr Bai also complained that Brick utilised a Transfer form that was "certified by Brick's solicitor purporting to be the solicitor for Brick and for Watson Elite". It is correct that the Transfer form was signed for Watson Elite by JC Legal Practice. However, the signing was effected pursuant to a Client Authorisation form that had been signed by Watson Elite in favour of JC Legal Practice on 30 June 2020. It was one of the numerous documents signed by

Watson Elite on that day. In these circumstances, there seems to be nothing irregular or improper about the signing of the Transfer form.

66 It follows from the above that the claims that the option to purchase was void, or that there was a personal equity against Brick which impeached its title as registered proprietor, have not been made out.

67 Upon registration of the Transfer, Brick obtained an indefeasible title as the proprietor of the fee simple in Lot 15. Brick later sold its interest in the property to a third party, and is entitled to the entirety of the proceeds of the sale, including the money that has been paid into Court (together with any interest earned thereon). It is not necessary to determine the extent to which those moneys would be payable to Brick on the basis that they would have been recoverable by it under its mortgage. That is to say, it is not necessary to determine whether, as claimed by Mr Bai, a Capital Reserve Fee of $30,800, and a Default Discharge Fee of $15,400, were unenforceable as penalties.

The claim against Mr Liangjie Chen

68 I turn now to Mr Bai's claim against Mr Liangjie Chen. Mr Bai sues him for breach of the warranty he gave on 22 October 2022 (see at [14] above). The warranty was in the following terms:

> I, Liangjie Chen, of 22 Delecta Avenue Mosman NSW 2088, hereby warrant to Yang Bai that Watson Elite Pty Ltd ACN 166 654 315 ('**Watson Elite**') will have sufficient funds within fourteen (14) days of this letter to fulfil the complete loan obligations owing by Watson Elite to Brick International Pty Ltd ('**Loan**'), to which the property situated at and known as U15, Lot 15 Array 27 Thornleigh Street, Thornleigh NSW 2120 is retained as security under the Loan and will cause that loan obligation to be repaid in full.

69 Mr Bai alleges that had the warranty been complied with, the mortgage to Brick would have been redeemed and Watson Elite would have been able to complete its contract to sell Lot 15 to Mr Bai. He alleges that he has suffered loss by reason of the breach of warranty. He assesses his loss at $900,000, as the value of the property, less any recovery made from Brick. The valuation figure is derived from the actual sale price on the contract entered into on 25 February 2021.

70 Mr Liangjie Chen filed a Defence to the claim, which contained denials of the relevant allegations. However, he did not appear at the hearing.

71 In my opinion, Mr Bai is entitled to succeed against Mr Liangjie Chen. It is clear that he provided the warranty in the terms set out above. The warranty was given in connection with the Deed of Indemnity entered into by Watson Elite and Mr Bai. It is clear (in particular from the email from Mr Bai's solicitors to Watson Elite's solicitors on 22 October 2022) that the warranty was given in consideration of Mr Bai's agreement to lodge his own caveat against the title to Lot 15.

72 I accept the submission that the warranty should be construed as a promise to effect a redemption of Brick's mortgage by repaying it in full. Viewed in the context of the circumstances that prevailed at the time the warranty was given, repayment of the mortgage in full would necessarily entail Watson Elite regaining the ability to transfer ownership of the property to Mr Bai. It would effectively amount to an unwinding of the option to purchase, such that Watson Elite and Brick would be treated as mortgagee and mortgagor respectively, pursuant to a mortgage that had been repaid in full.

73 It follows that had the warranty been true (i.e. that within 14 days of 23 October 2020 the loan would be repaid in full) Watson Elite would have regained the ability to transfer Lot 15 to Mr Bai. Further, given that Mr Liangjie Chen did not seek to contradict the assertion contained in Mr Bai's affidavit that the purchase price paid under his wife's contract was "carried across" to his contract to purchase Lot 15, and as no evidence was adduced to the effect that the instalment of 90% of the purchase price paid by Mr Bai's wife was not being treated as part of the purchase price under Mr Bai's contract, I would infer that Mr Bai would have been in a position to require Lot 15 to be transferred to him without having to make any further payment. That is, from about 6 November 2020, Mr Bai would have been able to call for a transfer of the property without having to make any further payment of purchase price.

74 Having regard to the proximity between that time and the date of the actual sale (and again noting the absence of any evidence to the contrary), I am prepared to accept that sale price as a reflection of the approximate value of the property in November 2020. On that basis, I would assess Mr Bai's loss by reason of the breach of warranty to be $900,000.

Conclusion

75 Judgment will be entered for Mr Bai against Mr Liangjie Chen in that amount, together with interest pursuant to s 100 of the *Civil Procedure Act 2005* (NSW) from 6 November 2020. The Court will further order that Mr Liangjie Chen pay Mr Bai's costs of the proceedings. In addition to the abovementioned judgment, an order will be made to the effect that the money paid into Court, together with any interest earned thereon, be paid to Brick. It will also be appropriate to order that Mr Bai pay Brick's costs of the proceedings. It is noted that Brick has foreshadowed that it may make an application for a special costs order.

76 The parties are directed to confer, and bring in within 14 days, Short Minutes of Order to give effect to these reasons and, if necessary, accommodate any application for a special costs order.

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