

Drafting Default Interest Provisions

by Joseph Lewin, Yelim Jun, and Miles Rennie

The High Court issued a finding in the case of *Houssein v London Credit Limited* [2025] EWHC 2749 (Ch) that helps to set out some interesting clarifications on the frequently-encountered question of what constitutes an unenforceable penalty in financing and lending agreements.

This judgment follows an earlier High Court judgment which found that a 4% default interest rate on a £1.88 million bridging loan amounted to a penalty and was therefore unenforceable (*Houssein v London Credit Limited* [2023] EWHC 1428 (Ch)).

That ruling was later overturned by the Court of Appeal (*Houssein v London Credit Limited* [2024] EWCA Civ 721).

The case was then remitted back to the High Court to consider whether the interest provision in the case constituted an unenforceable penalty. The High Court held that a default interest rate in a facility letter does not automatically constitute an unenforceable penalty, and the default interest rate of 4% was held to be enforceable.

Facts and Procedural Background

Mr and Mrs Houssein (the “**Housseins**”) owned a portfolio of residential properties, primarily held as investments, alongside their family home. The Housseins, via their company CEK Investments Ltd, entered into a one year bridging loan facility provided by London Credit Ltd (“**LCL**”) which carried standard interest at 1% per month and default interest at 4% per month (compounded monthly), triggered by any “**Event of Default**”. The Housseins personally guaranteed the loan and granted charges over some of the portfolio properties, including their family home.

The facility letter contained a non-residence covenant which was violated due to the Housseins’ continued occupation of their family home which was secured under the loan.

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LCL alleged that the breach of the non-residence covenant was an Event of Default which triggered the default interest rate.

At first instance, the judge held the default rate was an unenforceable penalty as it did not protect any legitimate interest of LCL.

Subsequently this was overturned by the Court of Appeal. which applied the test for determining whether a clause is a penalty (and therefore unenforceable) as set out in the Supreme Court judgment in *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67

1. is the provision a secondary obligation, i.e. an obligation arising on breach, as opposed to a primary obligation to perform: only secondary obligations can be penal;
2. does the provision protect a legitimate interest of the innocent party; and
3. is the detriment imposed out of proportion to that interest (i.e., extravagant, exorbitant or unconscionable)?

Judgment

The case was then remitted to the trial judge to determine whether the default interest provision in the present case was an unenforceable penalty.

The Court stated that *Makdessi* introduced a strong initial presumption in “*negotiated contract[s] between properly advised parties of comparable bargaining power*” and that the parties themselves would typically be the “*best judge of what is legitimate.*” Given the Housseins’ experience, the advice obtained from solicitors and mortgage brokers as well as the presence of other options during the process meant that such a presumption applied.

However, the Court held that that presumption could be overcome if, by reference to any Event of Default, the agreed sum is out of all proportion to the interest it protects. Further, as highlighted in *Makdessi*, instances where a single sum is payable for different breaches can be an indicator of a rate being penal.

Because the same blanket rate of 4% applied to different Events of Default of varying gravity, the Court treated the clause as failing if, by reference to any one protected interest, the rate was disproportionate. That required identifying the specific legitimate interests engaged by each of the Events of Default and testing the proportionality for each interest, rather than asking only whether the default interest of 4% was “high”.

The judge identified five interests within the facility letter:

1. **Repayment:** the lender’s core interest in getting the loan repaid in full and on time;
2. **Truth of Representations:** the lender’s interest in ensuring that the borrower’s statements and representations are true (since these form the basis for agreeing to lend);
3. **Security:** the lender’s interest in ensuring that the security or collateral for the loan remains valid and enforceable;

4. **Non-residence:** the lender's interest in ensuring that the property financed by the loan is not used as a residence (as doing so could make the loan fall under prohibited regulatory rules); and
5. **Credit risk:** the lender's interest in accounting for the borrower's creditworthiness (either predicting the risk of default before it happens or recognising that the default shows the borrower was a higher credit risk than expected).

The Court considered that evidence of typical market practice could be a helpful yardstick for what may be considered "extortionate." Applying the *Makdessi* presumption (as the Housseins were experienced borrowers and legally advised, with available alternatives), and market evidence showing 4% was at the upper end of the commercially acceptable range, the Court held the rate was not extortionate when measured against each interest.

As a result, the Court found that the provision was not void for reason of being a penalty.

The decision also clarified two points of practical importance:

1. default interest provisions are ordinarily secondary obligations as they are only payable in the event of a default of a primary obligation, and are therefore subject to the penalty rule; and
2. where an agreement makes the standard and default rates mutually exclusive, if the default rate is penal and unenforceable, the lender cannot instead rely on the standard rate for the same period.

Conclusion

There are some important practical implications for legal practitioners:

1. When drafting a single default rate across multiple Events of Default, practitioners should be ready to identify and justify the specific legitimate interest protected by each trigger. If one of the triggers is disproportionate, the entire provision is at risk.
2. While not definitive, contemporary market evidence can be decisive. Accordingly, practitioners should consider market evidence when drafting agreements with default rates.
3. Practitioners should be cautious about drafting agreements with mutual exclusivity. Where standard and default rates are drafted as mutually exclusive, if the default rate is held to be an illegitimate penalty, the lender cannot fall back on the standard rate for the same period.