An tOmbudsman Seirbhísí Airgeadais agus Pinsean
Financial Services and Pensions Ombudsman

Decision Ref:	2020-0019
Sector:	Banking
Product / Service:	Loans
Conduct(s) complained of:	Failure to consider vulnerability of customer Fees & charges applied
Outcome:	Partially upheld

LEGALLY BINDING DECISION OF THE FINANCIAL SERVICES AND PENSIONS OMBUDSMAN

Background

This complaint relates to a business term loan taken out by the Complainant Company with the Provider in **2010** and charges on the Complainant Company's business account.

The Complainant's Case

The Complainant Company submits that it first applied and was approved for a business loan in **August 2008** for €35,000. The Complainant Company submits that the loan was drawn down in stages between August 2008 and October 2008. The Complainant Company submits that it sought and was approved for a temporary overdraft in **December 2009**, as the business was not *"making enough money*".

The Complainant Company submits that it then applied for and was granted a top-up loan of circa €13,000 and a restructure in **January 2010** as the business *"was still struggling to keep up with its outgoings"*. The Complainant Company submits that it was struggling to meet the repayments, so the repayments were set semi-annually in **May 2010**.

The Directors of the Complainant Company submit that;

> *"I have no recollection of been advised about the loan other than my signing of the loan documents, I was in debt and heading further into debt and at this stage I think the Bank should have seen that my business was failing and that further borrowing was not the way forward. In 2010 I was a 22 year old young Irish man with a dream of building a successful business, in 2010 the [named Provider] was bailed out by the Irish*

State and giving the circumstances of the times the bank did not practice due diligence with my affairs, had the bank refused to restructure my original loan I would have had two options, file for bankruptcy or to restructure the old loan balance to a more affordable repayment at the time."

The Complainant Company says that the loan agreement of 26 May 2010 was *"reckless",* as the Provider set the Complainant Company *"on a difficult road with interest penalties and extra interest mounting as a result of no regular payments been made."*

The Complainant Company says that a verbal request was made on several occasions between June 2010 and sometime during 2015 for a small overdraft, but this was refused on the grounds of the Complainant Company's ability to repay.

The Complainant Company submits that the loan was finally restructured in March 2015 to weekly repayments of €102.43. The Directors of the Complainant Company submit the Provider *"mismanaged*" and "*misguided"* the Complainant Company as a customer and did not act in the "*best interests*" of the Complainant Company.

The Complainant Company also submits that it has requested an entire audit of its borrowings from day one and did not get a satisfactory answer.

The Complainant Company is seeking that the Provider "*acknowledge the current loan status and the effort that [the Complainant Company] ha[s] made to repay it quicker".* The Complainant Company would "*like to see a debt write down or the remaining balance struck off*" as it has paid *"so much interest over the life of this loan that I have more than paid back the amounts borrowed."*

The Provider's Case

The Provider submits that the Complainant Company applied for a Business loan in the amount of €35,000 which was drawn down on **1 September 2008**. The loan was subsequently restructured on four occasions over the next 6 years and three temporary overdraft facilities were approved for the Business Current account on **18 December 2009**, **21 December 2010** and **25 January 2011**.

The Provider submits that the Complainant Company has incurred interest and fees on both the Business Loan and the Business Current accounts, in line with the terms and conditions of the accounts.

The Provider submits that each application for credit is assessed on its own merits and that in January 2010, the Complainant Company sought and was approved for a Top-Up Business loan of €13,000 and agreed to restructure the existing loan. The Provider submits that the Letter of Guarantee and Indemnity for €44,000 dated **27 January 2010**, which secured the agreed provision of additional funds, was signed by the Complainant Company's Directors.

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The Provider submits that the Complainant Company wanted to amend the repayments to the Business Loan in **May 2010** and as this was a material change to the terms and conditions of his original loan, the Provider was required to provide a new Loan Offer letter, to reflect the change.

The Provider submits that on **30 June 2011** the Complainant Company called the Provider's collections department requesting an overdraft facility on the Business Current Account. The Provider submits that as the account was being managed by the Provider's Collections Department at the time that *"new lending would not be sanctioned".*

The Provider submits that the Complainant Company knowingly applied for refinance of its original Business Loan in January 2010 and amended the repayment frequency of the Business Loan in May 2010. The Terms and Conditions of the business loan clearly advised of the interest and fees applicable. The Provider submits that it is satisfied that charges were validly and correctly applied to the Complainant's loan accounts. The Provider submits that the evidence shows that the Complainant Company willingly entered into the agreements with the Bank and that it was fully *"informed"* and *"advised"* in the Company's decision.

The Provider submits that the Complainant Company missed a number of repayments on the Business Loan and as per the Terms and Conditions, interest was applied. The Provider submits that it notified the Complainant Company by letter and telephone that there were missed repayments on the business loan, as stated in the terms and conditions. The Provider submits that it also issued correspondence to the Complainant Company when its Business Current Account became overdrawn.

The Provider submits that on **20 May 2011**, the Business Loan Account was transferred to the Provider's Collections Department for management. The Provider submits that it agreed to accept lower repayments when the Complainant Company was struggling to meet the repayments. The Provider submits that Alternative Repayment Arrangements were entered into in **January 2013** for three months and in **August 2013** for four months. The Provider submits that the Complainant Company was advised that interest would continue to accrue during and after these periods on the *"outstanding balance of the Account at the current rate".*

The Provider submits that it agreed another ARA in **May 2014** of weekly payments of €100 for six months. The Provider submits that this agreement provided that the interest would be suspended while the agreement was in place. The Provider submits that it has been discovered that the interest and surcharges were not in fact suspended during this period, owing to an administrative error and has offered the Complainant Company a refund of €1,542.70 in relation to interest and surcharges charged out in the period 15 May 2014 to 16 September 2014.

The Provider submits that in **February 2015**, the Provider agreed to restructure the Business Loan account and made arrangements with the Complainant Company's branch to arrange a new business loan which provided the Complainant Company with a lower more sustainable repayment schedule. The Provider also says that in **June 2018** the Complainant Company was "*in fact ahead of schedule with the loan*" at that time.

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The Complaint for Adjudication

The Complainant Company's complaint is that in the period 2010 – 2015, the Provider failed to act in the best interests of the Complainant Company, insofar as:-

(a) The Provider made a top-up loan available to the Complainant Company in **January 2010** on a business loan account, at a time when the Complainant Company believes that it was obvious that the Company could not maintain repayments at the current level. The Complainant Company considers the original loan taken out in 2008 to have been an *"already failing debt"* in 2010 when the Complainant Company was wrongfully granted the top-up loan;

(b) The Provider wrongfully changed the frequency of the repayments on the business loan account to "*semi-annually*" in **May 2010**;

(c) The Provider failed to agree to an overdraft facility on the Complainant Company's business current account in **June 2011**;

The Complainant Company believes, as a result of the restructure in **2010**, the Provider "*enjoyed years of interest and penalties without trying to help*". The Complainant Company is unhappy with the application of interest, interest surcharges and penalties on its business loan and business current account. The FSPO notes the conduct complained of to be conduct of a continuing nature in the period from 2010 – 2015, within the meaning of ***Section 51(5)*** of the ***Financial Services and Pensions Ombudsman Act 2017***.

Decision

During the investigation of this complaint by this Office, the Provider was requested to supply its written response to the complaint and to supply all relevant documents and information. The Provider responded in writing to the complaint and supplied a number of items in evidence. The Complainant was given the opportunity to see the Provider's response and the evidence supplied by the Provider. A full exchange of documentation and evidence took place between the parties.

In arriving at my Legally Binding Decision I have carefully considered the evidence and submissions put forward by the parties to the complaint.

Having reviewed and considered the submissions made by the parties to this complaint, I am satisfied that the submissions and evidence furnished did not disclose a conflict of fact such as would require the holding of an Oral Hearing to resolve any such conflict. I am also

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satisfied that the submissions and evidence furnished were sufficient to enable a Legally Binding Decision to be made in this complaint without the necessity for holding an Oral Hearing.

A Preliminary Decision was issued to the parties on 17 September 2019, outlining the preliminary determination of this office in relation to the complaint. The parties were advised on that date, that certain limited submissions could then be made within a period of 15 working days, and in the absence of such submissions from either or both of the parties, within that period, a Legally Binding Decision would be issued to the parties, on the same terms as the Preliminary Decision, in order to conclude the matter.

Following the consideration of additional submissions from the parties, after the Preliminary Decision had been issued, and also taking account of additional information made available by the Provider in reply to new questions raised by this office on 18 October 2019, the final determination of this office is now set out below.

It is understood that the Complainant Company applied for and accepted a term loan in the sum of €35,000 in **August 2008** ("***Loan 1***").

In **January 2010**, the Complainant Company was approved for a term loan in the sum of €43,000. **("Loan 2")**.

I note that this office has not been furnished with a copy of the loan application form submitted by the Complainant Company to the Provider in or around January 2010. This document was requested by this office in the course of investigating this complaint. The Provider responded to this office's request by outlining the following;

> *"The [Provider] would like to note the Business Loan when approved led to the generation of the Consumer Credit Agreement (Loan Offer Letter) which reflected the facility requested, and confirmed the terms and conditions pertaining to the Business Loan.*
>
> *The Loan Offer Letter is the agreement with the Consumer and not the loan application from. The Loan Offer Letter is printed once the loan applied for has been approved.*
>
> *Copies of the Loan Offer Letters are included in the schedule of evidence above".*

It is not in dispute between the parties that the loan was sought by the Complainant Company to restructure the earlier loan accepted in 2008 and to secure top-up finance. The Provider, by letter dated 22 January 2010, informed the Complainant Company that the term loan was approved ("***Loan 2***"). That letter outlined that the loan was for €43,000, for a seven year period, payable monthly on a variable interest rate of 6.24%. The letter outlined that the Provider's *"usual T&C's, which are summarized for your convenience on the next page of this letter apply to this Term Loan".*

The letter outlined that the security required was *"joint & several letter of guarantee signed by* [Named Director] *and* [Named Director]." The office has been furnished with a copy of a

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Guarantee and Indemnity for €44,000, which I note has not been signed by either of the Directors of the Complainant Company. I note the letter dated 22 January 2010, does not contain a section for a signature or seal for and on behalf of the Complainant Company. The only signed document which has been furnished in evidence is a note that reads as follows;

> *"Certificate concerning Independent Legal advice*
> *I understand the nature of the liability incurred and I have no wish to be independently advised by a solicitor"*
> [Named Director Signature] 27/1/10

I note that the sum of €43,000 was drawn down, as it appears in the Complainant Company's loan account on 28 January 2010.

The documentation furnished shows that a business lending application form was completed by the Complainant Company and signed by the Directors of the Complainant Company on **26 May 2010** for a loan facility in the sum of €41,300.

The application, which is some 6 pages in length, is only completed in part, with sections such as Business Borrowing & Saving Details, Business Financial Details, Personal Financial details of the Shareholders, Security Proposed, and Attachments all not completed. I note that the section of the application form *"term of facility"* outlines *"14 years ½ yearly".*

The Provider then by letter dated 26 May 2010 informed the Complainant Company that a term loan was approved ("***Loan 3***"). That letter outlined that the loan was for €41,300, for a seven year period, payable bi-annually on a variable interest rate of 6.24%. The amount of each payment was outlined as €3,692.21. The letter then outlined that the Provider's

> *"usual T&C's, which are summarized for your convenience on the next page of this letter apply to this Term Loan".*

I note that again this letter does not contain a section for a signature or seal for and on behalf of the Complainant Company. The only signed document that appears is a document indicating that one of the Directors of the Complainant did not wish to protect the loan by way of payment protection insurance, signed on 26 May 2010.

I note that the sum of €41,300 appears to have been drawn down, as it appears in the Complainant Company's loan account on 04 June 2010.

Whilst there is an absence of signed documentation with respect to the loan agreements that were entered into between the Provider and the Complainant Company in January and May 2010, I accept that the parties entered into the loan arrangements; the Complainant Company by its own admission had applied for the loans, drew down those loans, and utilised the funds.

In this regard, I note that the Director of the Complainant Company outlines, as follows;

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"I approached my bank prior to 22nd January as my business was failing and needed capital, as you can see the bank granted me an overdraft of €2,000 from the 18th December 2010 to the 25th December 2010, the Bank agreed to restructure the loan and loan me a further €14,070.78.

I have no recollection of been advised about the loan other than my signing the loan documents, I was in debt and heading further into debt and at this stage I think the bank should have seen that my business was failing and that further borrowing was not the way forward…….had the bank refused to restructure my original loan I would have had two options, file for bankruptcy or to restructure the old loan balance to a more affordable repayment at the time."

The Complainant Company also submits;

"Yes I was aware and was wandering blindly into more debt on the Bank's approval of my second loan, if the Bank had acted in line with the Code of Conduct for Business Lending it would not have granted me that second loan and would have instead have reviewed my financial situation and deemed me at that point to be in financial difficulty."

The Complainant Company has submitted that the Provider has not complied with the Code of Conduct for Business Lending. In this regard, the Complainant Company has highlighted a number of provisions of the ***Code of Conduct for Business Lending to Small and Medium Enterprises (2012)***, which was operative from ***01 January 2012***. These include General principles 1, 2, 3, 4, 5, 6, 8, 9, 12. The Complainant Company has also submitted that there has been non-compliance with provision 2 and 5 in the Applications for Credit sections of that Code.

It is important to note that the relevant version of the ***Code of Conduct for Business Lending to Small and Medium Enterprises*** that was in effect at the time the loans were issued in January and May 2010, was the ***2009 publication.*** That 2009 Code does not contain any of the General Principles that the Complainant Company has submitted have been breached by the Provider.

The "Credit Facilities" and "Applications for Credit" sections of the ***2009 Code*** outline as follows;

*"**Credit Facilities***

"1. A regulated entity must offer its customers an option of an annual review meeting, to include all credit facilities and security.

Applications for Credit

2. A regulated entity must consider each application for credit facilities on its own merits.

3. A regulated entity must inform borrowers how long the process is considered likely to take. This information may be in statistical form, consistent with past experience, or be based on service targets set by the regulated entity.

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4. *A regulated entity must maintain records of all applications for credit facilities.*
5. *A regulated entity must have appropriate procedures in place to assess a loan application.*
6. *Where a new application for credit is approved, a regulated entity must provide the borrower with confirmation of the credit facilities granted and the terms and conditions applying thereto, including those regarding default, together with relevant details of fees, charges and interest rates. In addition, a regulated entity should outline to the borrower the next steps to be completed to facilitate drawdown."*

It appears to me that the crux of the Complainant Company's complaint that the Provider failed to act in the Complainant Company's best interests, with respect to the loans issued and accepted in 2010, is that the Provider should not have approved those borrowings for the Complainant Company and that the re-payment structure of the loan was not suitable for the Complainant Company. The Complainant Company has expressed the view that it should have been deemed by the Provider to be in *"financial difficulty"* at the time.

I note the original Term Loan 1 (from 2008) was in place at the time the Complainant Company sought the top-up finance and restructure. It is understood from the Term Loan Statements with respect to Loan 1 that the Complainant Company, was meeting its monthly payments of €527.39 on that loan since the loan's inception in October 2008 up until January 2010, when the top-up and restructure of the 2008 loan was sought by the Complainant Company.

In circumstances where the Complainant Company was servicing Loan 1 at the time and the loan was not in arrears, I take the view that there is no apparent reason why the Provider should have deemed the Complainant Company to be in "*financial difficulties*" under the ***Code of Conduct for Business Lending to Small and Medium Enterprises (2009).*** Further it also appears from the Term Loan statements that the Complainant Company was meeting its monthly payments of €632.47 between February and May 2010 with respect to Loan 2, such that there was no reason for the Provider to deem the Complainant Company to be in "*financial difficulties*" under the ***2009 Code*** when the restructure to bi-annual payments was sought by the Complainant Company, and Loan 3 was drawn down in May 2010.

I accept the Provider's submission that its lending criteria are *"commercially sensitive"*. The Provider says that it "*assessed the Complainant's financial information and circumstances and made its decision, based on the information provided by the Complainant*." The Provider submits that it carried out a "*full affordability and suitability assessment*" prior to advancing additional monies to the Complainant Company. It must also be borne in mind that the FSPO will not interfere with a financial service provider's decision to accept or reject a consumer's request for credit, other than to ensure that the Provider complies with relevant codes/regulations and does not treat the applicant unfairly or in a manner that is unreasonable, unjust, oppressive or improperly discriminatory. There is no evidence before me to suggest that the Provider processed the Complainant's application unfairly or unreasonably.

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I can find no evidence that the Provider was discriminating against the Complainant or that its behaviour was oppressive in granting the Complainant Loan 2 to facilitate the top-up requested, and the restructure of the original 2008 Term Loan in January 2010 or in May 2010 when the repayment structure was changed to bi-annual payments (Loan 3). Likewise, the FSPO will not interfere with the commercial discretion of a financial service provider, in refusing to make overdraft facilities available to a customer.
It is notable that the complaint made by the Complainant Company against the Provider essentially expresses dissatisfaction with the Provider's decision to make loan facilities available to the Complainant Company in 2010, and with its failure to not make overdraft facilities available to the Complainant Company in June 2011. It is difficult to comprehend the apparent conflict in those two positions as the Complainant Company's position is that the Provider's willingness to make facilities available to the Complainant Company in 2010 was "*reckless*", but nevertheless it expresses dissatisfaction with the Provider's unwillingness to do so in 2011.

The fact remains that the Complainant Company sought the additional credit from the Provider in January 2010 and then sought the amendment to the repayment structure in May 2010. As outlined above, the Complainant Company was not in arrears with the existing Term loans held with the Provider at those times. Furthermore, there is no evidence that the Complainant Company did not comply with the ***Code of Conduct for Business Lending to Small and Medium Enterprises (2009)***, at the time in 2010.

Furthermore, the Complainant has submitted that granting the Complainant Company the top-up on the loan and structuring the payments on a bi-annual basis was *"reckless"* on the part of the Provider. It should be noted however, that the Courts have made it clear over the last number of years that there is no tort of "*reckless lending*" in this jurisdiction. The High Court in ***Harrold v Nua Mortgages [2015] IEHC15*** confirmed that it was clear from the evidence in that case that the plaintiff had applied for the loan, drawn down the loan, spent the fund and was undoubtedly a willing participant in the transaction. There was no credible evidence that the plaintiff had been "*lured into a contract*" or coerced or induced in any way to sign up to the mortgage agreement. The High Court also pointed out that any suggested non-compliance with the statutory code, did not relieve a borrower from his obligations under a loan to repay the lender, nor did it deprive the lender of its rights and powers under the loan agreement. Having regard to the above, I am of the view that there is no evidence before me to suggest that the loans made available by the Provider to the Complainant Company in 2010 were *"reckless".*

The Complainant Company says that as a result of the restructure in 2010, the Provider "*enjoyed years of interest and penalties without trying to help*". The Complainant Company is unhappy with the application of interest, interest surcharges and penalties on its business loan and business current account.

With respect to the business term loan, it is noted that the Complainant Company did not make any payment on the restructured Loan 3. The first bi-annual payment was due on 30 December 2010.

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It appears that Loan 3 was then restructured by way of agreement dated 01 March 2011 ("***Loan 4***"). That letter outlined that the loan was for €43,346, for a seven year period, payable monthly on a variable interest rate of 6.24%. The first repayment of €637.55 was outlined as due on 20 March 2011. The letter outlined that the Provider's *"usual T&C's, which are summarized for your convenience on the next page of this letter apply to this Term Loan".*

I note that again this letter does not contain a section for a signature or seal for and on behalf of the Complainant Company. The only signed document that appears is a document indicating that one of the Directors of the Complainant Company did not wish to protect the loan by way of payment protection insurance, signed on 01 March 2011.

It is noted that the Terms and Conditions of the Term Loan taken out in March 2011 ("***Loan 4"***) outline as follows;

> ***OBLIGATIONS***
>
> *It is essential that repayments are made in accordance with the repayment schedule agreed and specified in the Letter of Offer. In the event of any repayment of principal or payment of interest in respect of the loan not being paid on the due date therefor or in the event of any material adverse change in the circumstances affecting the Borrower, the loan or the security for the loan, or in the event of any material adverse change in the circumstances of any other obligations of the Borrower to the Bank or to any other member of the [Provider's name] or to any other financial institution(s); or in the event of any breach by the Borrower of any terms and conditions of the loan or any obligations of the Borrower to the Bank or any other member of the [Provider's name] or any other financial institution(s); the Bank may adopt any of the following courses of action:*
>
> *1. Terminate the agreement and call in the advance; or*
> *2. Revise the rate category; or*
> *3. Re-negotiate the terms*
>
> ***<u>Warning</u>, if you do not meet the repayments on your loan, your account will go into arrears. This may affect your credit rating***
>
> ***INTEREST***
>
> *The interest rate, which may vary during the period of the lending, is determined by reference to the Borrower's category and the term, purpose of, and security for the advance.*
>
> *Interest is calculated on the daily balance outstanding, after adjustment is made for cheques in course of collection, and is charged to accounts at the relevant Bank charge dates.*

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Any sum not paid by the Borrower to the Bank by its due date shall be subject to an additional interest charge at the rate of 0.75% per month or part month (ie 9.000% per annum) subject to a minimum of €2.54 per month from such due date until payment, in addition to the relevant interest charge, to accrue both before and after any judgment and shall be charged to the Borrower's account and payable at the same time, in the same manner as the relevant interest charge.
The said rate or minimum amount may at any time and from time to time be changed by the Bank at its absolute discretion. Additionally, where any sum is not paid by its due date, the Bank may, at its discretion alter the amount, which is subject to the additional interest charge. In the event of any such change or alteration occurring during the continuance of this facility, the Bank will give the Borrower a minimum one month's prior notice that such change or alteration is to take place. Any such additional interest charge is intended to constitute liquidated damages to the Bank, including compensation for its increased administrative and related general costs occasioned by the default of the Borrower. Notice under this clause may be given by the Bank to the Borrower by any means the Bank considers reasonable."

Following the March 2011 restructure, the Complainant Company fell into arrears. I note from the Statements for the term loan (Loan 4), that the Complainant Company did not make payment on the loan in March and April 2011. The Complainant Company was issued with correspondence by letter dated 14 May 2011, advising of the arrears. The Complainant then made a manual payment of €1,000 on 25 May 2011. A further payment of €219.02 was made on 20 June 2011 to clear the arrears of €219.02. The standing order from August 2011 was not paid, as there were insufficient funds in the Complainant Company's account. The Provider wrote to the Complainant Company on 29 August 2011 to advise of this. The standing order from October 2011 was then again unpaid, as there were insufficient funds in the Complainant Company's account. The Provider wrote to the Complainant Company on 27 October 2011 to advise of this.

This cycle continued throughout 2012, with standing orders missed in January, February and March 2012 and again from June to August 2012. Manual payments were made by the Complainant Company of varying sums during this time. The Director of the Complainant Company was in continuous contact with the Provider's Credit Services team by telephone throughout this time. The audio recordings of those telephone calls have been reviewed and I note that the Provider's Credit Services team assisted the Complainant Company's Director to make manual payments, advised the Complainant Company's Director of the consequences of not meeting the loan repayments, in terms of interest and the Irish Credit Bureau ("ICB") record and of the consequences of standing orders being returned unpaid for the Complainant Company's current account.

In January 2013, the Provider offered the Complainant Company an interim payment arrangement of €500 for three months. The Complainant Company made manual payments of €250 on 05 February and 11 February 2013. The March and April 2013 standing orders of €500 were met by the Complainant Company. The Complainant Company continued to make manual payments of €500 in May and June 2013.

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A further interim payment arrangement was offered to the Complainant Company in August 2013, for a payment of €1,000 upfront and then, monthly payments of €637.55 for four months (September to December 2013). The standing orders for these monthly payments were not met and manual payments of varying sums were made during the four month period.

I certainly sympathise with the Complainant Company, as it is understood from the telephone calls that took place during this timeframe, that the seasonal nature of the work, the downturn in the economy and expected payments not being made to the Complainant Company in full or on time, left the Director of the Complainant Company in a positon where the Complainant Company was in difficulty meeting the repayments required under the Term Loan, on time. However it remains the case that the Term Loan was sought by the Complainant Company and the Complainant Company was contractually obliged to make the repayments agreed.

I note that the terms of the January and August 2013 arrangements, which were accepted by the Complainant Company provided as follows;

> *"All other existing Terms and Conditions, including Interest and Interest Surcharges, continue to apply to the account/s and the Bank continues to reserve its rights under the existing Terms and Conditions (i) in the event of your failure to meet the interim payment arrangements as agreed or (ii) in the event of any other breach of the existing Terms and Conditions. However any use of these rights will be subject to our compliance with the Code."*

Further manual payments were made by the Complainant Company between February and May 2014. The Provider offered the Complainant Company a further interim repayment arrangement in May 2014, for a weekly payment of €100 for 6 months. The Provider agreed to "suspend" the interest while the agreement was in place. It is noted that due to an administrative error the interest was not however suspended and the Provider has offered to refund the Complainant Company interest and surcharges of €1,542.70 which were applied in error during this period. The Complainant Company did not accept this refund, pending the conclusion of the adjudication of this complaint.

I note that the Term Loan was again restructured by way of agreement dated 02 March 2015 ("***Loan 5***"). It is understood that as of June 2018, the Complainant Company was ahead of the repayment schedule on that loan.

As outlined above since March 2011, the Complainant Company defaulted on the Term Loan 4 repeatedly by failing to make the standing order repayments. The terms and conditions that were furnished to the Complainant Company, and as are quoted above are clear about the consequences of failing to make payments on time, in that an additional interest surcharge would accrue. Furthermore the interim arrangements entered into by the Complainant Company of January and August 2013 were clear that if agreed repayments were not met that additional interest would accrue on the Term Loan. The Director of the Complainant Company was also advised of this by telephone on numerous occasions from March 2011 and August 2013.

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The issue of such "additional" interest or surcharge interest has been the subject of some considerable scrutiny by the Courts, which I will refer to below;

Case Law

According to Breslin and Corcoran:

> "*A clause in a loan agreement to the effect that the amount of interest payable upon a default by the borrower is automatically increased, may be unenforceable if, properly construed, it is a penalty*".
>
> [Breslin and Corcoran, *Banking Law* (4th ed, 2019, Round Hall), paragraph 8–037].

The leading Irish authority is the Supreme Court decision in *Pat O'Donnell & Co Ltd v Truck and Machinery Sales Ltd* [1998] 4 IR 191, which focused on the distinction between a permissible genuine pre-estimate of damage and an impermissible sum in excess of any actual damages that would possibly or probably arise from breach.

In ACC Bank Plc v Friends First Management Pension Funds Ltd [2012] IEHC 435, the question of whether default interest in a loan contract was a penalty was considered by Finlay Geoghegan J. On the evidence, each side's expert agreed that where a facility goes into default, it would be re-categorised as impaired. This classification has cost implications for the lending bank because it will need to set aside an increased level of capital for the anticipated loss. It appears also to have been agreed that the actual cost to the bank would vary according to the nature of the default. Finlay Geoghegan J. concluded that the interest surcharge of 6% per annum could not be considered to be a reasonable pre-estimate of loss. Application of the surcharge trebled the margin on the facility, and almost doubled the applicable interest rate, and the entire surcharge was triggered even if one interest payment fell into arrears. This was not, therefore, akin to the minimal 1% additional interest found to be acceptable and enforceable in the UK decision of *Lordsvale Finance Plc v Bank of Zambia* [1996] QB 752. At paragraph 79, Finlay Geoghegan J. expressed the basic rule, as endorsed in *Pat O'Donnell*, as requiring the court to determine whether or not the additional sum payable is a genuine pre-estimate of the probable loss by reason of the breach. The court should determine whether the predominant contractual function of the provision was to deter a party from breaking the contract or to compensate the innocent party for breach, by comparing the amount that would be payable on breach with the loss that might be sustained if a breach occurred.

In *AIB plc v Fahy* [2014] IEHC 244, O'Malley J accepted that "*a bank is entitled in principle to charge surcharge interest where a borrower is in default*" but held the surcharge interest rate of 12% to be a penalty where the bank offered no evidence as to the basis for its calculation so it could not be seen as a genuine pre-estimate of loss.

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Most recently in *Sheehan v Breccia* [2018] IECA 286, the clause under scrutiny provided for a 4% per annum uplift in interest payments. Expert banking evidence was heard in the High Court to show that while it was not possible to accurately predict the level of loss that would be incurred on default, banks are likely to incur additional risk and administrative costs when a loan goes into default. The default or surcharge rate was almost double that of the normal interest rate applying under the loan. The creditor, a co-shareholder in the underlying business, argued that where a precise pre-estimate of damage was impossible and the provision was commercially justifiable, the bargain made between the parties should be respected provided the surcharge was not extravagant or unconscionable. This approach was rejected by the Court of Appeal which indicated that only the Supreme Court could reconsider the principles as to whether a surcharge interest clause is or is not a penalty.

Speaking for the Court of Appeal (at paragraph 22), Finlay Geoghegan J. noted that:

a) the onus of establishing that a clause is a penalty rests on the party alleging same; and
b) the question of whether a clause is penal must be assessed at the time the agreement was entered and not at the date of breach.

Finlay Geoghegan J. held (at paragraph 40) that the question for the court to determine was "*whether or not the additional sum payable is a genuine agreement for the payment of liquidated damages*". This question then turns on whether or not the additional sum payable represents a genuine pre-estimate of the probable loss to the innocent party by reason of the potential breaches of contract to which the clause applies. The learned judge accepted that latitude ought to be applied where there is a difficulty in establishing a pre-estimate of the damage suffered where there is probable variation in what loss and damage that will in fact be suffered. As a result, Finlay Geoghegan J. held (at paragraph 44) that the question could be phrased as a determination of whether "*the clause is a genuine attempt by the parties to estimate <u>in advance</u> the loss which will result from the breach*" (emphasis added).

In *Sheehan v Breccia*, Finlay Geoghegan J. concluded that the 4% surcharge interest clause in question was not a genuine attempt to agree upon liquidated damages or estimate the loss which the original lender might suffer by reason of a relevant default. In reaching this conclusion, the learned judge noted that the clause was contained in the bank's general terms and conditions. Accordingly, it could not have been a genuine advance estimate of the bank's loss arising on a breach of the specific loan agreement between the bank and the borrowers. She further noted that expert evidence established that the probable loss depends on an interplay between the amount outstanding at the time of default, the value of the security ultimately realised, and the cost in time or effort in achieving these outcomes. The judge further accepted that the experts were in agreement that the pre-estimate of probable loss in the event of default formed part of the analysis which the bank did prior to determining the general interest rate to be applied to the facility.

<u>Surcharge Interest charged to the Complainant Company</u>

Because of the position adopted by the Courts regarding surcharge interest, I asked the Provider on 18 October 2019, for details of all such surcharge interest which it had charged

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to the Complainant Company, owing to the account having fallen into arrears, in the period 2010 – 2015, quite apart from the figure of €1,542.70 which the Provider had already advised that it was due to refund. I asked the Provider to specify the precise percentage/s of surcharge interest, applied to the Complainant's accounts during that period, and to specify precisely where within the parties' agreement such surcharge interest is provided for, ie please specify the contractual clause/s relied upon by the Provider in that regard.
I gave the Provider the opportunity to address the principles examined by the Court of Appeal in *Sheehan v. Breccia [2018] IECA 286,* and to advise whether the surcharge interest applied to the Complainant's account was believed by the Provider to represent a genuine estimate in advance, of the loss resulting from the breach by the Complainant Company of the agreed repayment terms.

I also asked the Provider to confirm whether at the time when it refunded the figure of €1,542.70 to the Complainant Company's account, any additional interest or goodwill payment was applied to the account, by way of compensation for the Provider's failure to identify its error at an earlier stage.

The provider's letter of 8 November 2019, did not respond to these additional individual queries, but rather advised that;

> *"Having reviewed this case again in its entirety, the Bank can confirm that it will not be seeking to recover any surcharge interest on the Complainant's accounts and will be refunding all surcharge interest that that has been applied to date … The Bank can now confirm the total amount to be refunded is now €2,122.89 (to take account of the additional €580.19 surcharge interest)"*

When the Preliminary Decision was issued to the parties on 17 September 2019, I had noted that the overpayment of interest and surcharges of €1,542.70 from May to September 2014, and any additional interest triggered by the application of those charges to the account, fell to be repaid, whether or not the Complainant Company considered such repayment of the Complainant Company's monies, to be adequate to address any aspect of its grievances. I noted indeed that whilst it was assumed that the Provider had by then refunded the Complainant Company, but if it had not done so already, the Provider should address this as soon as possible.

It seems however from the Provider's letter of 8 November 2019, that although the figure of €1,542.70 should not have been charged by the Provider from May to September 2014, this figure had yet to be refunded by the Provider, and still remained "due" to be refunded, in addition to the extra refund of surcharge interest then confirmed. This is very disappointing.

I take the view that this approach has been less than ideal, and I am satisfied that the Provider should compensate the Complainant company for its delay in that regard.

I note that the ***Code of Conduct for Business Lending to Small and Medium Enterprises (2012)*** came into effect on 01 January 2012, while the Complainant Company was in arrears on the Term Loan. I note that provision 17 of the Code provides as follows below. Having

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regard to all of the interactions between the Provider and the Complainant Company during the period that the Complainant Company was in arrears, it appears to me that the Provider was acting in accordance with the Code and in a fair and reasonable manner to assist the Complainant Company in resolving the financial difficulties.

> *"Where a regulated entity is working with a borrower to address the borrower's financial difficulties in accordance with the policies and procedures established by the regulated entity, a regulated entity must:*
> *a. give the borrower reasonable time, from the time a borrower is classified as in financial difficulties, having regard to the circumstances of the case, to resolve the financial difficulties; and*
> *b. endeavour to agree an approach with the borrower that will assist the borrower to address the financial difficulties."*

Finally, the Complainant Company takes issue with charges on the Business Account for standing orders returned unpaid. The Terms and Conditions of the Complainant Company's Business Account at Clause 3.2 provided for the application of Unpaid Charges where standing orders due to be paid were unpaid. The obligation was on the Complainant Company to ensure that there were cleared funds in the account to ensure that the standing orders for the Complainant Company's term loan repayments to be made. I note that the Provider waived the Unpaid Charges on occasion on telephone calls with the Complainant Company. Clause 3.2 outlines as follows;

> *"The Customer shall ensure that there are sufficient cleared funds….in the Account to meet payments from the Account ("debits") as listed below;*
> *…*
> - *Standing orders and direct debits which are due to be paid*
>
> *…*
> *Debits presented for payment that are not paid are subject to Unpaid Charges."*

On the basis of the evidence before me, I do not accept that the Provider failed to act in the best interests of the Complainant Company in the period from 2010 – 2015. The evidence before me discloses that the Provider made available to the Complainant Company those facilities which the Complainant itself had sought for the purpose of continuing with its commercial operations, except that the overdraft facilities sought in 2011 were declined at that time, owing to the Complainant Company's repayment record. Throughout 2013, 2014 and into 2015, a number of Alternative Repayment Arrangements were made available by the Provider in order to assist the Complainant Company in meeting its liabilities to the Provider, during a period when the Complainant Company was under considerable financial pressure.

The Provider however has a case to answer to the Complainant regarding the monies which fall due to be re-paid by it to the Complainant, being

- the figure of €1,542.70 interest and surcharges which pursuant to the Provider's agreement, should not have been charged by the Provider from 2014 onwards, and

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- €580.19 additional surcharge interest which the Provider no longer now seeks to charge.

Bearing in mind the period during which the Complainant Company has been out of pocket in that regard, I also consider it appropriate for the Provider to make a compensatory payment to the Complainant Company to take account of those particular circumstances.

I am satisfied therefore, on the basis of the evidence before me that the complaint against the Provider should be partially upheld, but only to the limited extent which is outlined.

Conclusion

- My Decision pursuant to ***Section 60(1)*** of the ***Financial Services and Pensions Ombudsman Act 2017***, is that this complaint is partially upheld on the grounds prescribed in ***Section 60(2) (g).***

- Pursuant to ***Section 60(4) and Section 60 (6)*** of the ***Financial Services and Pensions Ombudsman Act 2017,*** I direct the Respondent Provider to rectify the conduct complained of by immediately refunding the Complainant Company the sum of €2,122.89. I also direct the Provider to make an additional compensatory payment to the Complainant Company in the sum of €850, to an account of the Complainant Company's choosing, within a period of 35 days of the nomination of account details by the Complainant to the Provider. I also direct that interest is to be paid by the Provider on the said compensatory payment of €850, at the rate referred to in ***Section 22*** of the ***Courts Act 1981***, if the amount is not paid to the said account, within that period.

- The Provider is also required to comply with ***Section 60(8)(b)*** of the ***Financial Services and Pensions Ombudsman Act 2017.***

The above Decision is legally binding on the parties, subject only to an appeal to the High Court not later than 35 days after the date of notification of this Decision.

MARYROSE MCGOVERN
DIRECTOR OF INVESTIGATION, ADJUDICATION AND LEGAL SERVICES

7 January 2020

Pursuant to *Section 62* of the *Financial Services and Pensions Ombudsman Act 2017*, the Financial Services and Pensions Ombudsman will publish legally binding decisions in relation to complaints concerning financial service providers in such a manner that—

(a) ensures that—

(i) a complainant shall not be identified by name, address or otherwise,

(ii) a provider shall not be identified by name or address,

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and

(b) ensures compliance with the Data Protection Regulation and the Data Protection Act 2018.