An tOmbudsman Seirbhísí Airgeadais agus Pinsean
Financial Services and Pensions Ombudsman

Decision Ref:	2021-0280
Sector:	Banking
Product / Service:	Loans
Conduct(s) complained of:	Fees & charges applied
Outcome:	Upheld

LEGALLY BINDING DECISION
OF THE FINANCIAL SERVICES AND PENSIONS OMBUDSMAN

Although the complaint is made jointly by the Complainants, the loan account the subject of this complaint is in the sole name of the First Complainant. The First Complainant restructured existing loan facilities pursuant to a Letter of Offer dated **23 June 2010**. These facilities were restructured again pursuant to a Letter of Offer dated **29 February 2012**. The First Complainant defaulted in his repayment obligations and surcharge interest was applied to his loan account by the Provider. The Complainants dispute the Provider's entitlement to charge surcharge interest in respect of these facilities.

For the purpose of setting out the position of each party to this complaint, it is important to note that the parties have separately indicated that the submissions made in the course of a linked complaint, connected to the parties, apply equally to this complaint.

The Complainants' Case

The Complainants state that the Provider applied a generic surcharge interest rate to the First Complainant's loan account totalling €1,677.72 including compounding. An *Interest Audit Finding* dated **25 April 2018** prepared by the Complainants' representative has also been furnished. It is submitted that surcharge interest is not a true reflection of the cost to the Provider nor was it negotiated. Therefore, as per the numerous legal cases on the issue of surcharge interest, including a recent decision of the Court of Appeal, render this provision unenforceable. The Provider is now refusing to refund the surcharge interest despite legal precedent on the charging of this type of interest.

In a letter dated **17 January 2019**, the Complainants' representative has referred to three High Court decisions: ***ACC Bank plc v Friends First Managed Pensions Funds Limited*** [2012] IEHC 435; ***AIB plc v Fahy*** [2014] IEHC 244; and ***Sheehan v Breccia*** [2016] IEHC 67, stating that all three deal with the issue of surcharge interest. In an email dated **3 April 2019**, the decision of the High Court in ***Benray v Breccia*** (13 August, 2015) is also referred to.

In a letter dated **7 March 2019**, the Complainants' representative explains that it has sought to identify whether the surcharge interest applied to the loan met three criteria, as set out in the various judgments, stating:

1. The interest rate applied was not negotiated with the First Complainant;

2. The surcharge rate applied (9% per annum) was a generic rate contained in the terms and conditions; and

3. The surcharge interest rate did not represent a genuine pre-estimate of loss arising from default.

It is submitted that the Provider has failed to show the interest rate applied was a genuine pre-estimate of probable loss, and that it was negotiated with the First Complainant and not a generic rate. In a submission dated **4 November 2019**, it is submitted that the rate applied by the Provider is significantly higher than the surcharge rates considered by the courts in several judgments and it well above the *modest uplift* allowable under Irish law.

In resolution of this complaint, the Complainants want a refund of the surcharge interest (including compounding) applied to the loan and reimbursement for all professional costs and expenses incurred in resolving this issue.

The Provider's Case

The Provider wrote to this Office on **19 February 2019** requesting that it decline to investigate the linked complaint pursuant to ***section 52(1)(f)*** of the ***Financial Services and Pensions Ombudsman Act 2017*** (the **Act**) on the basis that the subject matter was of such a degree of complexity, the courts were a more appropriate forum to determine the dispute. The Complainants' representative disagreed with the Provider's position on the matter as outlined in its letter of **7 March 2018**. On the basis of the Provider's position that the submissions made in respect of the linked complaint are to be taken as applicable to this complaint, I consider the same objection to have been made in respect of this complaint.

By letter dated **27 March 2019**, the Provider addressed the matters arising in this complaint under three separate headings: (i) *Accord and Satisfaction*; (ii) *Limitations Periods*; and (iii) *Specific Issues Raised by the Complainant*.

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Accord and Satisfaction

The Provider submits the legal principal of accord and satisfaction applies to this complaint as the Complainants and associated parties entered a Debt Settlement Agreement with the Provider dated **20 March 2015**, (the **DSA**). The DSA confirmed the terms whereby the Provider would settle and forbear in relation to all of the parties' combined debt obligations and liabilities, and they agreed *'… in consideration of the mutual agreements set out below (and for good and valuable consideration, the receipt of which is acknowledged by each of the Parties) …'.*

In my Preliminary Decision I stated:

> *…Subsequent to the execution of the DSA, a Receiver appointed by the Provider disposed of most of the secured assets…*

However, in a post Preliminary Decision submission, the Provider details that it "*made the majority of Receiver appointments over its Secured Assets in November 2013, so the Receiver appointments occurred prior to execution of DSA rather than subsequent to same".* [the Provider's emphasis added]

There was a surplus remaining upon the completion of this process, a variation of the DSA was mutually agreed between the Provider and the Complainant whereby in consideration for the payment of €300,000, two properties with a value of approximately €2 million were returned to the Complainant. Additionally, the Provider did not require the disposal for two other properties and also released a mortgage over a principal private residence.

The Provider refers to a definition of accord and satisfaction in ***Chitty on Contract*** (Volume 1 – General Principles, 32nd ed., 2015), as *"… the purchase of a release from an obligation whether arising under contract or tort by means of any valuable consideration, not being the actual performance of the obligation itself …."* It is submitted the *accord* in this instance equates with the agreement between the parties, the DSA, and the obligations to be complied with by each, whereby the Complainants' obligations to the Provider are discharged. The *satisfaction* is the consideration or acts of each party to be observed and performed, so as to make the agreement operative. The Provider states this legal premise relies on a decision of ***British Russian Gazette and Trade Outlook Limited v Associated Newspapers Limited*** (1933). The Provider submits that although the release (the Provider's forbearance/settlement) is in a form normally ineffective to discharge a contract and which is executionary on one side only, it will operate as a discharge if the other party (the Provider) agrees to accept some other or additional consideration in return for the right which it abandons.

Chitty states that once a valid compromise has been reached, on mutually acceptable terms, *'… it is open to the party against whom the claim is made to avoid the compromise on the ground that the claim was in fact invalid, provided that the claim was made in good faith and was reasonably believed to be valid by the party asserting it.'*

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It is further noted by ***Chitty*** that in order to establish a valid compromise *'… it must be shown that there had been an agreement (accord) which is complete and certain in its terms, and that consideration (satisfaction) has been given or promised in return for the actual forbearance to pursue the claim. It is a good defence to an action for breach of contract to show that the cause of action has been validly compromised.'*

The Provider submits that, as stated in ***British Russian Gazette***, where there is a clear and unconditional discharge, abandonment or release of a claim by one party (the Provider) in return for the promised performance by the other party (the First Complainant/the Complainants) of a series of acts, that original claim can never be revived.

Chitty states that *'… the claimant [the Provider] will agree to accept the other party's promise of performance in satisfaction of his claim. The original claim is then discharged from the date of the agreement [the DSA] and cannot be revived.'*

It is stated that it is not open to the First Complainant/the Complainants, having fully compromised and settled all debt obligations to the Provider, to seek to re-open the Provider's claim and argue or dispute certain terms and provision of the Provider's claim which cannot be revived.

The Provider also refers to a passage in **Foskett*, The Law and Practice of Compromise***, (2nd ed, 1985) *'… Generally speaking a compromise agreement will discharge all original claims and counterclaims unless its express content provides for their revival in the event of breach.'* It is submitted that it is evident from the DSA that its terms do not envisage that either party can reopen or initiate any further dispute in relation to the matters compromised and agreed in the DSA, which include and refer to the repayment of the debt due by the First Complainant as referenced in Schedule 1 - Part 1, the Facility Letter; Part 2 (the Guarantees); and Part 3, the Schedule of Liabilities.

Limitation Periods

The Provider refers to ***section 51*** of the Act and the time limits for making a complaint pursuant to ***section 44(1)(a)***. It is stated that the Offer Letter is dated **29 February 2012** and this letter contains, as a term in the bespoke appendix drafted specifically for the Complainants, reference at clause 8, the Provider's entitlement to charge surcharge interest where *"… any amount (is) not paid by the Borrower to the Bank by its due date."* Within a very short period of the loan being drawn down, the First Complainant defaulted on the express repayment obligations, thus triggering the application of surcharge interest. Accordingly, the Complainants and their advisors were aware and on notice of the existence of the surcharge interest provisions prior to and certainly on the date of the Offer Letter which was negotiated, agreed and signed in excess of 6 years ago, thus being *"… 6 years from the date of the conduct giving rise to the complaint."*

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Alternatively, the Complainants became aware or reasonably should have been aware of the application of surcharge interest when this was first charged as of **May 2012** and at various stages thereafter until the DSA was entered into. The Provider remarks that at no stage during the period **May 2012** to late **2014** did the Complainants raise any issue or concern with respect to the application or payment of surcharge interest, even though the Complainants *"… became aware, or ought reasonably to have become aware, of the conduct giving rise to the complaint … during this period."*

Further to this, the Provider states that when Complainants entered the DSA, details of the various liabilities would have been brought to their/the First Complainant's attention, as well as details of interest payable and accrued, including surcharge interest would have been brought to their/the First Complainant's attentions as part of the negotiations and discussions in advance of execution of the DSA.

Specifically, details of the relevant liabilities were set out in Schedule 1, Part 3 and no issues were raised as to the quantum or calculation of these amounts. At no point prior to the negotiation or execution of the DSA or immediately thereafter did the First Complainant/the Complainants raise any issue with the inclusion of surcharge interest as part of the liabilities due to the Provider.

The Provider also submits that there are no reasonable grounds to allow a period of greater than either 6 years or 3 years for the making of this complaint, and it would be unjust and inequitable to do so.

Specific Issues Raised by the Complainants

The Provider submits there are legal complexities to this complaint, and solely relying on High Court and Court of Appeal decisions does not take into account the factual matrix which applied to each individual case and whether relevant terms/provisions in one set of circumstances actually apply or are relevant to this particular complaint. It is stated that the Provider was contractually entitled to apply its surcharge interest rate provisions during **2012** until late **2014** given that the ***Friends First*** decision was not raised at that time, and the ***Breccia*** decision was not determined at that stage. The Provider also draws a number of distinctions between the present complaint and a Legally Binding Published Decision of this Office referenced by the Complainants' representative.

The Provider's letter of **27 March 2018** was followed by an extensive exchange of submissions which included detailed legal submissions in respect of the various points raised.

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Jurisdiction

The Provider has advanced two principal grounds as to why this Office does not have jurisdiction to investigate this complaint.

First, owing to the complexity of the complaint it argues that the courts are the more appropriate forum for determining this complaint. Secondly, it argues that the complaint has not been made within the time limits prescribed by the Act.

Section 50(2) of the Act states that where a question arises as to whether this Office has jurisdiction to investigate a complaint, *"… the question shall be determined by the Ombudsman whose decision shall be final."*

Dealing with the first point raised by the Provider, ***section 52(1)(f)*** of the Act states that this Office ***may*** decline to investigate a complaint if:

> *"the subject matter of the complaint is of such a degree of complexity that the courts are a more appropriate forum."*

While extensive and detailed submissions have been furnished by both parties, the Provider has not identified what it is about this particular complaint that renders its subject matter *of such a degree of complexity* that it should not be investigated by this Office. However, having considered the subject matter of this complaint and the parties' submissions, I am not satisfied this complaint has any particular degree of complexity which would require this Office to decline to investigate it pursuant to ***section 52(1)(f)*** of the Act. Therefore, I determine that this Office has jurisdiction to investigate this complaint.

The second point raised in relation to jurisdiction by the Provider is one as to time limits. The time limits for the making of complaints to this Office are set out in ***section 51*** of the Act. The Complainants claim that surcharge interest was wrongfully applied to the loan account the subject of this complaint.

In my Preliminary Decision I stated:

> *It is not entirely clear when the Complainants say the charging of surcharge interest began or stopped, if at all. From the Interest Audit Findings dated* ***25 April 2018****, it would appear this began around* ***November 2010*** *and continued to* ***December 2015****. However, it is not clear if surcharge interest continued to be applied to the loan to date. The complaint was made to this Office on* ***24 September 2018****.*

The Provider in its post Preliminary Decision submission detailed that "*Surcharge Interest was only charged/applied to the Account between 22 November 2010 and 20 November 2011 and comprised 4 separate quarterly interest payments only (the "****SI Charge Period****")".* The Provider further maintains in its post Preliminary Decision submission that "*no further Surcharge Interest was applied to the Complainants' Account at any stage after November 2011, save for the SI Charge Period*".

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The First Complainant entered two loan agreements with the Provider. The first in **June 2010** and the second in **February 2012**. The facilities restructured on foot of each Letter of Offer were effectively to be repaid on demand or within 12 months from restructure.

Additionally, these facilities were in respect of the same loan account number and one was a restructure of the other. In light of the terms/duration of these loans, they do not constitute a long term financial services within the meaning of the Act. Accordingly, the time limit contained in ***section 51(1)*** of the Act applies, meaning that the complaint must be made not later than 6 years from the date of the conduct giving rise to the complaint. However, ***section 51(5)*** of the Act is also of relevance to a determination as to whether this complaint was made within the appropriate time limit. ***Section 51(5)*** states:

> *"For the purposes of subsections (1) and (2)-*
>
> *(a) conduct that is of a continuing nature is taken to have occurred at the time when it stopped and conduct that consists of a series of acts or omissions is taken to have occurred when the last of those acts or omissions occurred, …"*

Taking into consideration the Letters of Offer and the Complainants' evidence showing the continued and essentially uninterrupted charging of surcharge interest, I am satisfied the conduct complained of comes within the meaning of ***section 51(5)***. Therefore, the time limit for the making a complainant pursuant to ***section 51(1)*** begins to run, at the earliest, from **22 December 2015**, being the date on which the conduct stopped/last occurred. This date is not disputed by the Provider. Accordingly, I am satisfied this complaint was made within the appropriate time limit.

The Complaint for Adjudication

The complaint is that the Provider wrongfully applied surcharged interest to the First Complainant's loan account.

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 Complainants were 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.

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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 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 3 June 2021, outlining my preliminary determination 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 issue of my Preliminary Decision, both parties made further submissions to this Office, copies of which were exchanged between the parties.

Having considered the parties' additional submissions and all submissions and evidence furnished by both parties to this Office, I set out below my final determination.

The Provider in its post Preliminary Decision submission, detailed in response to my statement "*taking into consideration the Letters of Offer and the Complainants' evidence showing the continued and essentially uninterrupted charging of surcharge interest, I am satisfied the conduct complained of comes within the meaning of* ***section 51(5)****."* While the Provider has submitted in its post Preliminary Decision submission that the "*SI Charge Period does not represent "continued and essentially uninterrupted charging of Surcharge Interest",* having considered the Complainants' evidence and their post Preliminary Decision submission, it would appear that "*interest continued to be charged by* [the Provider], *on the surcharge interest that was applied, on an ongoing basis"* until the loan account was closed.

Therefore, it remains my view that the time limit for the making a complainant pursuant to ***section 51(1)*** begins to run, at the earliest, from **22 December 2015**, being the date on which the conduct stopped/last occurred. This date is not disputed by the Provider. Accordingly, I am satisfied this complaint was made within the appropriate time limit.

The Loan Facilities

The First Complainant entered into a loan agreement with the Provider pursuant to a Letter of Offer dated **23 June 2010** (the **First Letter of Offer** or the **First Facility**). Several amounts were advanced to the First Complainant on foot of this facility. However, €2,699,668 was advanced in respect of the loan the subject of this complaint. The purpose the loan was to restructure an existing facility. The parties executed a Letter of Offer dated **29 February 2012** (the **Second Letter of Offer** or the **Second Facility**) which *replaces and supersedes* the First Facility. Again, several amounts were advanced on foot of this facility.

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A total of €2,716,833.71 was advanced in respect of the loan the subject of this complaint. The purpose of the advance was to restructure an existing facility. The interest rate in respect of the First Facility was 5.89% and 2.36% in respect of the Second Facility.

Dispute over Surcharge Interest

The Complainants' representative wrote to the Provider on **30 April 2018**, taking issue with the application of surcharge interest to the First Complainant's loan.

The Provider responded on **11 September 2018** as follows:

> *"**Surcharge Interest***
>
> *The Bank issued a restructured Offer Letter to [the First Complainant] dated 23rd June 2010 (the **"2010 Offer Letter"**) with appended terms and conditions, as set out in the appendix to the 2010 Offer Letter, which was accepted by [the First Complainant].*
>
> *I refer specifically to clause 8A (i) and (iii) of the terms and conditions in the appendix to the 2010 Offer Letter, the Bank was contractually entitled to seek an additional Interest charge from [the First Complainant] as the stated rate of 0.75% per month (by way of Interest Surcharges) upon the happening of the stated events…*
>
> *To the extent that [the First Complainant] failed to discharge his contractual obligations and make the agreed Interest payments as set out in the 2010 Offer Letter, despite having contracted and agreed to such arrangements …; then, such failure to repay the agree Interest amounts was deemed an Event of Default … entitles the Bank to charge the said Interest Surcharges. …"*

The Surcharge Interest Clause

The First Letter of Offer does not reference the surcharge interest provisions. However, the Second Letter of Offer under the section *Interest Rate*, states:

> *"Surcharge interest will continue to be charged in accordance with Clause 8 of the Terms and Conditions in respect of the above facilities."*

Clause 8 of the Terms and Conditions for both facilities is essentially identical and provides for the charging of surcharge interest. Clause 8 states as follows:

> ***"8. Interest Surcharges***
>
> ***8A. Interest Surcharges Rates and amounts on which Interest Surcharges will be charged***

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An additional interest charge at the rate of 0.75% per month or part of a month (i.e. 9% per annum) subject to a minimum of €2.54 per month will be paid by the Borrower on the following amounts:

(i) any amount not paid by the Borrower to the Bank by its due date.

(ii) any amount not repaid on the Bank's demand where such demand is made in the case of an Overdraft facility or other facility repayable on demand;

(iii) any outstandings which become repayable by the Borrower to the Bank following the occurrence of an Event of Default pursuant to Clause 12 of these Terms and Conditions;
and

(iv) the amount of any overdrawn balance which has not been authorised by the Bank's prior agreement or any overdrawn balance which is in excess of the overdraft limit authorised by the Bank's prior agreement.

8B. Periods of Accrual of Interest Surcharge

The additional interest charge provided for above shall accrue;

(i) in the case of any sum not paid by the Borrower on tis due date, from such date until the relevant sum if paid in full;

(ii) in the case of any sum repayable by the Borrower on the Bank's demand (and whether such sum is outstanding by way of Overdraft or otherwise), from the date of such demand until the relevant sum is repaid in full;

(iii) in the case of any outstandings which have become repayable by the Borrower to the Bank pursuant to Clause 12 of these Terms and Conditions (Events of Default), from the date from which such outstandings become payable or repayable to the Bank pursuant to Clause 12 of these Terms and Conditions until such outstandings are repaid or discharged in full;

(iv) in the case of any unauthorised Overdraft balance or any excess over an authorised Overdraft balance, from the date such authorised Overdraft balance or excess occurs until it is repaid in full; and

(v) in all cases both before and after judgment as appropriate.

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8C. Surcharge Interest – Additional

The Borrower shall discharge interest due to the Bank at the rate relevant to the amounts owing by the Borrower to the Bank in addition to any amount of additional interest as provided for in this Clause 8.

8D. When and How Surcharge Interest is Payable

The additional interest charges provided for in this Clause 8 shall be payable by the Borrower to the Bank at the same time and in the same manner as the relevant interest charge, currently quarterly. Such additional interest shall be charged to the Borrower's account or accounts with the Bank.

8E. Liquidated Damages

Any such additional interest charge as is provided for in this Clause 8 is intended to constitute liquidated damages to the Bank including compensation for its increased administrative and related general costs occasioned by:

(i) the Borrower's default in payment of any amount when due including when such amount becomes due on the Bank's demand; and or

(ii) the Borrower causing any unauthorised Overdraft or any unauthorised excess over an authorised Overdraft limit to occur; and or

(iii) the Borrower otherwise defaulting in respect of the Borrower's obligations to the Bank.

8F. Change in Interest Surcharges

The rate or minimum amount of additional interest charge provided for in Clause 8A above may at any time and from time to time be changed by the Bank at its absolute discretion, subject to approval by the relevant Regulatory Authority.

In the event of any such change or alteration occurring during the continuance of a facility, the Bank will give the Borrower a minimum of 30 days prior notice that such change or alteration is to take place.

Notice under the Clause 8F may be given by the Bank to the Borrower by any means the Bank considers reasonable."

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The Law on Surcharge Interest Clauses

According to **Breslin and Corcoran** in ***Banking Law*** (4th ed., Round Hall, 2019, para. 8-037), *"A clause is 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."*

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 discussed the distinction between a permissible genuine pre-estimate of damage and an impermissible sum in excess of any actual damage that would possibly or probably arise from a 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 had 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 surcharge interest of 6% per annum could not be considered a reasonable pre-estimate of loss. The application of surcharge interest trebled the margin on the facility, and almost doubled the applicable interest rate, and the entire surcharge rate 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 of her judgment, 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 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 a bank offered no evidence as to the basis for its calculation so it could not be seen as a genuine pre-estimate of loss.

Most recently, in ***Sheehan v Breccia*** [2018] IECA 286, the clause under scrutiny before the Court of Appeal provided for a 4% per annum uplift in interest payments. Expert banking evidence was led 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.

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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 who indicated that only the Supreme Court could reconsider principles as to whether a surcharge interest clause is or is not a penalty.

Speaking on behalf of the Court of Appeal, Finlay Geoghegan J noted (at paragraph 22) in essence that:

1. The onus of establishing that a clause is a penalty rests on the party alleging this.

2. The question of whether a clause is penal must be assessed at the time the agreement was entered not at the date of breach.

3. While there is a reluctance on the part of the Courts to interfere with the terms of a contract agreed between two parties of equal bargaining power, the willingness to do so in relation to a clause which is determined to be a penalty is an exception to the general rule.

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 damaged."* 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 judge accepted that latitude ought to be applied where there is a difficulty in a pre-estimate of the damage suffered where there is probable variation in what loss and damage 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).

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 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. It was 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.

Finlay Geoghegan J 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.

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Analysis

The Debt Settlement Agreement

The main point raised by the Provider in response to the Complainants' claim that surcharge interest was wrongfully applied to the First Complainant's loan account is premised on the principle of *Accord and Satisfaction*, in that the DSA entered into in **March 2015**, which is a compromise agreement, precludes the Complainants from now raising the issue of surcharge interest.

The evidence is that the First Complainant defaulted on his interest repayment obligations under the First Letter of Offer dated **23 June 2010**. Having reviewed the definition of *Facility Letters* and the facility letters contained in the Schedule 1 of the DSA, the First Letter of Offer is not expressly stated as being subject to the DSA. While, for the purposes of the restructuring of the First Complainant's facilities, the Second Letter of Offer replaced and superseded the First Letter of Offer, in the context of the provisions of the ***Financial Services and Pensions Ombudsman Act 2017***, this is not sufficient to prevent the present complaint being made to this Office. The conduct giving rise to the complaint commenced under the terms of the First Letter of Offer and was continued by the Provider under the terms of Second Letter of Offer.

Leading on from this, I do not accept the Provider's submission as to the effect of the DSA. Having considered the terms of the DSA, in particular clauses 2 to 5, the DSA appears to be more akin to a non-recourse agreement. For example, clause 2 states:

> *"**2** **Agreement***
>
> *2.1 Subject to and conditional upon the Obligations:*
>
> *…*
>
> *the Bank's recourse to the assets of the Obligors for the Outstanding Obligations shall be limited to Secured Assets and any proceeds from the sale or other realisations of the Secured Assets. In the event that the Outstanding Obligations are discharged in full the Bank will release the Secured Assets from the Security.*
>
> *2.2 Notwithstanding any other provision of this Agreement, nothing in this Agreement shall prejudice any recourse, rights and/or remedies which the Bank may have:*
>
> *2.2.1 to the Secured Assets, any estate or interest of any Obligor, or any other person, in the Secured Assets and/or the proceeds of sale of the Secured Assets or other realisations of the Secured Assets; and*

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> 2.2.2 *to pursue any claim or take any legal proceedings against the Obligors or any other person where the Bank deems it appropriate for the purpose of enforcing the Bank's security or disposing of any of the Secured Assets or pursing sum due from any person other than the Obligors;*
>
> *which rights are hereby expressly preserved and nothing in this Agreement shall operate, or be construed, as a release or discharge of any right or asset which the Bank holds as security under or in connection with any of the Facility Letters and/or the Guarantees.*
> *…"*

As can be seen from a perusal of the DSA, it does not expressly exclude or preclude either party taking action of foot of the First or Second Letters of Offer. Rather, it prevents recourse to certain assets. Even if this is not the case, I am not satisfied the DSA is sufficient to prevent a complaint being made to this Office in respect of the charging of surcharge interest. Contrary to the Provider's position, this is not dispute regarding a breach of contract. Within the meaning of the ***Financial Services and Pensions Ombudsman Act 2017***, this is a *complaint* in respect of the *conduct* of the Provider in charging surcharge interest.

Furthermore, the Provider has simply stated its position as to the legal effect of the DSA without engaging with the specific terms of the agreement to demonstrate precisely how it constitutes an accord and satisfaction or compromise in the manner contended. Such a cursory level of engagement with the terms of the DSA is not sufficient to support its position.

In addition to this, the Provider has not identified any Irish Authority in favour of its interpretation of the DSA and has only referred to English textbooks and case law. In a submission dated **24 July 2019**, the Provider states, in respect of surcharge interest, that *"… it is not open to the Complainant's representative to opine or determine what the appropriate or correct legal interpretation of penalty clauses might be, absent a Supreme Court determination on the matter …"* If I am to accept the principle underpinning this proposition which is that a party to this complaint cannot express a view as to the interpretation of contractual terms in the absence of Supreme Court authority; then, it follows that I should not accept the Provider's position regarding the DSA in light of the clear absence of Irish legal authority to support its interpretation of this agreement.

Finally, the foregoing analysis is very much informed by ***section 12(11)*** of the ***Financial Services and Pensions Ombudsman Act 2017***, which states:

> *"Subject to this Act, the Ombudsman, when dealing with a particular complaint, shall act in an informal manner and according to equity, good conscience and the substantial merits of the complaint without undue regard to technicality or legal form."*

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Therefore, I do not accept that the DSA precludes the Complainants, particularly the First Complainant, from making a complaint in respect of the charging of surcharge interest.

Surcharge Interest Clause

Applying the legal principles outlined above, I accept the Complainants bear the burden of establishing that clause 8 is a penalty. In support of their position, the Complainants have referred to case law, the fact clause 8 was not individually negotiated or discussed in respect of either facility at the time they were entered into and it constitutes a generic term. The view is also expressed by the Complainants' representative (which is a financial services firm engaged in advising clients whether, for example, they have been subject to penalty interest rates) that clause 8 is not a genuine pre-estimate of loss.

The question as to whether clause 8 is a penalty is to be assessed at the time the agreement was entered into. The Provider has not made any submission or proffered any evidence to assist this Office in assessing the rationale for including a 9% annual surcharge interest rate at the time each of the facilities were entered into.

The question of whether the agreement provides for the repayment of liquidated damages normally falls to be decided by determining whether the clause is construed as a genuine pre-estimate of loss. Little assistance can be gleaned from the wording of clause 8 in particular clause 8E which simply states *"… Clause 8 is intended to constitute liquidated damages to the Bank including compensation for its increased administrative and related general costs …"* I do not consider this is sufficient to render clause 8 a liquidated damages clause as opposed to a penalty. The real question is whether the clause can be considered as a genuine pre-estimate of loss. However, the Provider has not made any submission or furnished any evidence in relation to an advance estimate of the costs or losses that might be occasioned on foot of the First Complainant's default. Further to this, the Provider has not identified the factors, if any, that were considered by it when determining that a 9% surcharge interest rate was appropriate to the First Complainant as an individual borrower to compensate for whatever costs might arise in the event of default.

It is recognised that latitude ought to be applied where there is a difficulty in a pre-estimate of the damage suffered where there is probable variation in what loss and damage will in fact be suffered. Equally, it cannot be denied that there is a difficulty or likely to be difficulty associated with estimating the probable damage that will be suffered by a lender should a borrower default on the loan facility.

This is because probable damage depends on an interplay between regulatory capital requirements, the amount outstanding at the time of default, the extent of the breach, the value of any security ultimately realised, and the cost in time and effort in remedying the default position. I would also accept the observations by ***Breslin and Corcoran*** (at paragraph 8-044) that *"[a] default interest rate addresses the borrower's impaired credit, the true cost of which is normally impossible to quantify precisely."*

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Therefore, while latitude should be applied, I would expect some form of explanation from the Provider, who set the rate in clause 8, for its rationale in attributing a 9% surcharge interest rate to the First Complainant's facilities. As the matter is phrased in ***Breccia***, there is no evidence before me of *"a genuine attempt of the parties to estimate in advance the loss which will result from the breach."*

The fact a surcharge interest provision is contained in the general terms and conditions of both facilities tends to show that clause 8 could not have been a genuine advance estimate of the Provider's loss arising from a breach of the relevant facility or that it was individually negotiated. The Provider's letter of **11 September 2018** would support this position as it is stated that:

> *"The Bank issued a restructured Offer Letter to [the First Complainant] dated 23rd June 2010 (the **"2010 Offer Letter"**) with appended terms and conditions, as set out in the appendix to the 2010 Offer Letter, which was accepted by [the First Complainant]."*

There was no reference to surcharge interest in the First Letter of Offer, and while there was a brief reference to clause 8 in the section Letter of Offer, it simply explained the continued application of clause 8 to the restructured facility. I do not consider the reference to clause 8 in the Second Letter of Offer is sufficient to constitute a genuine attempt to estimate in advance the likely damage arising from a breach.

While the courts had the benefit of expert evidence in the cases referred to above in respect of whether the clauses in question were penalties, no such evidence has been tendered by the parties to this complaint. However, I believe that I am entitled to have regard to the nature of the evidence required by the courts and tendered by the parties to those cases, to assist me in my consideration of this complaint.

The surcharge interest rate contained in clause 8 is 9%. This is squarely within the range of surcharge interest rates that have been struck down by the courts and almost 4% higher than the interest rate applicable to the First Complainant's facilities.

Accordingly, I am satisfied it has been established that clause 8 is a penalty. Moreover, the Provider has not advanced any submissions or evidence to show otherwise. Therefore, on the basis of the relevant legal principles and the foregoing analysis, I am not satisfied clause 8 as contained in the terms and conditions of both Letters of Offer can properly be described as providing for the payment of liquidated damages following default. Rather, clause 8 is designed to deter a breach of contract.

Hence, it is more properly described as a penalty as there is no evidence of an attempt by the Provider to estimate in advance, the losses that would result from the First Complainant's default under either facility.

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Therefore, I am not satisfied the Provider was entitled to apply surcharge interest to the First Complainant's loan facilities pursuant to clause 8 and any interest applied to the facilities pursuant to clause 8 was wrong and should not have occurred.

The First Complainant has not expressly identified when surcharge interest was first applied to the loan. The *Interest Audit Findings* seem to indicate that such interest was first applied in or around **22 November 2010** and continued until **22 December 2015**. This period covers the facilities extended on foot of both Letters of Offer. The Provider appears to accept that surcharge interest was applied to the First Complainant's loan. It is stated in the Provider's letter of **11 September 2018** that the First Complainant defaulted on the interest repayment obligation contained in the First Letter of Offer. However, no comment is made in respect of the period during which this occurred.

By letter dated **9 April 2020**, the Provider offered *"… a full refund in the amount of* ***€1,677.72*** *(representing the total amount claimed by the Complainant). …"* The Provider's willingness to refund the amount claimed by the Complainants is welcome. In my Preliminary Decision I had stated that despite the Provider's willingness being welcomed, it is not entirely clear when surcharge interest was first applied to the loan. Further to this, having considered, in particular, the comments of the Complainants' representative in a letter dated **21 April 2020** and the evidence in this complaint, I am not entirely satisfied as to when surcharge interest was first applied and also, ceased to be applied to the loan account.

While I acknowledge that the Provider has submitted in its post Preliminary Decision submission that no "*further Surcharge Interest was applied to the Complainants' Account at any stage after November 2011, save for the SI Charge Period*". As is clear from the matters set out above, I am not satisfied the Provider was entitled to charge surcharge interest pursuant to the First Complainant's loan.

This also means that it was improper for the Provider to continue to charge surcharge interest on the loan. Accordingly, any such interest should be refunded to the First Complainant.

Therefore, I uphold this complaint and direct that the Provider refund the surcharge interest and also pay a sum of €3,000 in compensation to the First Complainant.

Conclusion

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

I direct pursuant to ***Section 60(4)(a)*** of the ***Financial Services and Pensions Ombudsman Act 2017***, that the Respondent Provider rectify the conduct complained of by ascertaining the date on which surcharge interest was first charged to the First Complainant's loan commencing with the Letter of Offer dated **23 June 2010**, and the amount of all such interest charged in respect of both facilities the subject of this complaint.

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I further direct pursuant to ***Section 60(4)(a)*** of the ***Financial Services and Pensions Ombudsman Act 2017***, that the Respondent Provider rectify the conduct complained of by refunding all surcharge interest charged to the First Complainant's loan pursuant to both facilities, accounting for any compounding or capitalising of that surcharge interest.

I direct, pursuant to ***Section 60(4)(d)*** of the ***Financial Services and Pensions Ombudsman Act 2017***, that the Respondent Provider pay the sum of €3,000 to the First Complainant to an account of the First Complainant's choosing, within a period of 35 days of the nomination of account details by the First Complainant to the Provider.

I also direct that interest is to be paid by the Provider on the said compensatory payment, 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.

GER DEERING
FINANCIAL SERVICES AND PENSIONS OMBUDSMAN

19 August 2021

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, and

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