THE HIGH COURT

CHANCERY

[2014 No. 2851P]

BETWEEN:

JIM STAFFORD

PLAINTIFF

-AND-

RONALD MCCOURT

AND

ASHCLIFF GUESTHOUSES LIMITED

DEFENDANTS

JUDGMENT of Mr. Justice Twomey delivered on the 4th day of December, 2017.

Summary

1. This case involves borrowings by an individual, the first named defendant, which were secured on his two guesthouses. Having failed to honour his loan agreement, the borrower claims that the bank cannot enforce its security, through its receiver, the plaintiff, against the two guesthouses because the borrower entered into a lease of those guesthouses with a company controlled by him, the second named defendant. He claims that, as the bank was aware of that lease, the lease takes priority over the bank's mortgage and so the receiver appointed by the bank is not entitled to possession of the guesthouses. For the reasons set out in this judgment and in reliance on *Fennell v. N17 Electrics* [2012] IEHC 228, this Court concludes that the bank did not consent to the alleged lease and therefore that the alleged lease in this case does not have priority over the bank's mortgage.

2. It is also noted that the commercial realities of this case are that the borrower is claiming that his own company was a tenant in the properties with the consent of the bank which, if upheld by this Court, would mean that the borrower would have obtained a €1.25 million loan from the bank while effectively giving the bank a worthless security. This would leave the bank high and dry while the borrower walks away in possession of the premises through his company. If it were that easy for a borrower to borrow funds, fail to repay them and then continue to use, through his company, the secured property, it would be a very significant disincentive to banks to engage in commercial lending.

Factual background

3. The first named defendant, Mr. McCourt, borrowed €1.25 million from Anglo Irish Bank, which was renamed as IBRC, following the merger of that bank with Irish Nationwide Building Society ("Anglo"). The borrowings were secured over two guesthouses which he owns in Dublin; 21 Harrington Street, Dublin 2 and the 10 Warrington Place, Dublin 2. The security was granted by him pursuant to a Mortgage Deed dated 12th August, 2002, entered into between Anglo and Mr. McCourt (the "Mortgage Deed"). It has been conceded on behalf of Mr. McCourt that a demand was made by Anglo in relation to the repayment of the loan and that there was default by Mr. McCourt in relation to that demand. The plaintiff, Mr. Jim Stafford ("the Receiver"), was appointed as a receiver to the two guesthouses on the 21st February, 2014.

4. In these proceedings the Receiver is seeking possession of the two guesthouses. Mr. McCourt and the second named defendant, Ashcliff Guesthouses Limited ("Ashcliff"), are resisting the claim for possession on the grounds that there is a lease between Mr. McCourt as lessor and Ashcliff, as lessee, over the two guesthouses, which takes precedence over the charge registered by Anglo over the two guesthouses. Mr. McCourt claims this lease was in existence at the time the mortgage was executed by him in favour of Anglo. The alleged lease appears to be an oral lease as no written terms were adduced in evidence. The only evidence adduced regarding the terms of the alleged lease was a reference in documetnation to a rental amount paid by Ashcliff to Mr. McCourt. The substance of Mr. McCourt's claim is that the clauses in the Mortgage Deed which he signed, prohibiting him from leasing the mortgaged premises, are subject to the consent of Anglo and that Anglo was aware of the lease and therefore consented to it.

5. It is relevant to note that in addition to the money which is owed by Mr. McCourt pursuant to the terms of the loan with Anglo secured on the two guesthouses, it was also claimed by the Receiver, and not denied by Mr. McCourt, that there is a further sum of €170,000 owed by Mr. McCourt to the Receiver. This arises from the fact that an interlocutory injunction in these proceedings was settled on the basis that Mr. McCourt would pay all the rent in respect of the two guesthouses to the Receiver, pending the full hearing of the action, which he has failed to do.

6. It is also relevant to note that on the date of the mortgage, Mr. McCourt was a director of Ashcliff, which company was 99% owned by him. Thus, Mr. McCourt was at one and the same time both the alleged landlord and the controller of the alleged tenant of the two guesthouses. The essence of Mr. McCourt's defence to these proceedings by the Receiver seeking possession of the two guesthouses is that on the date of the mortgage there was a lease in existence between him and Ashcliff. It is curious therefore that Mr. McCourt (in his own right, or as the director and controller of Ashcliff) chose not to give any evidence in this trial and in particular that he chose not to give any evidence in respect of the lease which is the basis of his defence to the Receiver's claim for possession.

Onus on Mr. McCourt to establish the existence of a lease that was consented to by bank

7. The failure of Mr. McCourt to give evidence is particularly curious, when one considers that, as is clear from *Murphy v. Hooton* [2014] IEHC 266, where a borrower is alleging that a lease takes priority over a bank's security and where the borrower has signed a mortgage deed to the effect that he cannot lease the mortgaged property without the consent of the bank, the onus is on the borrower to establish that the lease existed and was consented to by the bank. It was noted by Peart J. at paragraph 22 of that judgment, in the context of a clause in a mortgage deed which prohibited leasing without the consent of the lender (in that case, Clause 11(L)):

> "In my view the evidence of acquiescence or even consent must be clear. It must be clear also exactly what the terms to which they are deemed to have accepted are. The effect of Clause 11(L) and clauses like it cannot be negated by stealth

or accident. Where it is sought to imply by its conduct that the lender has acquiesced or given up its entitlement to the protection of such a clause, the facts must be clear so that an intention to do so is clearly made out, in circumstances where the need for a prior written consent is so clearly spelled out. The onus is on the defendant to establish these matters clearly."

Evidence provided on behalf of Mr. McCourt that bank consented to the lease

8. The only witness called on behalf of Mr. McCourt was Mr. Frank Kenny, a financial adviser/broker who negotiated the loan with Anglo on his behalf. Particular reliance is placed by Mr. McCourt on the letter issued by Mr. Kenny dated 30th May, 2002, to Anglo, which was prior to the execution by Mr. McCourt of the Mortgage Deed on the 12th August, 2012. For this reason, it is relevant to set out some pertinent extracts from that letter:

> "Dear Alan
>
> With reference to the above and our recent meeting, I now enclose herewith for your perusal a proposal for funding in the sum of €1.25m.
>
> Ronald McCourt is aged 38 and is Managing Director and 99% owner of Ashcliff Guesthouse Ltd which trades as Huband House Guesthouse, Warrington Place and Harrington House Guesthouse, Harrington St, Dublin 2. The promoter has traded successfully at both these locations since 1996.
>
> […]
>
> Mr McCourt has requested a total loan facility of €1.25m secured on two well established and well located Bed & Breakfasts at 10 Warrington Place Dublin 2 and Harrington House, 21 Harrington Street Dublin 2.
>
> Both premises are in excellent condition and were recently valued by Pat Hickey (Auctioneering) Ltd at €1m & €1.27m respectively. As such, loan to value will be in the region of 55% which is well within guidelines. As additional security, an appropriate level of mortgage protection (to be agreed) will be effected on the life of the promoter ad assigned to Anglo Irish Bank.
>
> Overall, the bank will be well secured for its advances.
>
> Repayments on the proposed facility over a term of 20 yrs will amount to c. €100,000pa. The applicant has requested an interest only facility for the first year which will result in annual interest payments of c. €78,000.
>
> Audited accounts in respect of Ashcliff Guesthouse Ltd are enclosed for the 12 month trading period ending 30.06.01. These indicate turnover of 314,000(Irl) and a profit after tax of c 81,000(Irl) after charging depreciation of 12,000(Irl) and Directors Emoluments of 27,000(Irl). The company also paid Mr. McCourt rent and rates of 57,000(Irl) during the trading period in question. These figures compare with turnover of 235,000(Irl) and a profit before tax of 51,000(Irl) after charging a similar level for Depreciation, Directors Emoluments, Rent & Rates (30.06.00).
>
> Based on the audited figures for 30.06.01 and adding back Directors Emoluments, Rent & Rates repayment cover of 2:1 exists with interest cover of 2.7:1. According to Mr McCourt trading for the current year is at a similar level despite the aftermath of Sept 11.
>
> Overall, repayment capacity would appear to be strong."

Did the bank consent to the lease?

9. For this Court, the key issue in this case is whether the evidence which is adduced on behalf of Mr. McCourt is such as to lead to a conclusion that Anglo consented to the lease with Ashcliff such that the lease takes priority over its charge over the property.

10. This is because the right of a mortgagor under s. 18 of the Conveyancing Act, 1881, to lease the mortgaged property is subject to a contrary intention being expressed in the mortgage, as is clear from the terms of that section:

> "18(1) A mortgagor of land while in possession shall, as against every encumbrancer, have, by virtue of this Act, power to make from time to time any such lease of the mortgaged land, or any part thereof as is in this section described and authorised.
>
> […]
>
> 18(13) This section applies only if and as far as a contrary intention is not expressed by the mortgagor and the mortgagee in the mortgage deed, or otherwise in writing, and shall have effect subject to the terms of the mortgage deed or of any such writing and to the provisions therein contained."

In this case, the Mortgage Deed contains several expressions of contrary intention:

> "Clause 1.1
>
> Encumbrance means a mortgage, charge […] and any leasing agreement […] or other instrument creating or evidencing any rights over the relevant Mortgaged Properties in favour of any other party"
>
> "Clause 4
>
> To the intent that the same shall be a continuing security to the Lender for payment of the Secured Liabilities, the Mortgagor as beneficial owner:-
>
> 4.1.1 Hereby grants and conveys unto the Lender all the Mortgagor's property of the freehold tenure including the property specified in Schedule 1 hereto (not being property registered under the Registration of Title Acts) to hold the

same unto the Lender in fee simple subject to the proviso for redemption hereinafter contained."

"Clause 6

The Mortgagor is not entitled, without the prior consent of the Lender which may be granted or withheld at the Lender's absolute discretion, to create or permit to subsist any Encumbrance on or affecting any part of the Mortgaged Properties."

"Clause 19

The statutory powers of leasing and accepting surrenders of leases of the Mortgaged Properties shall not be exercised by the Mortgagor without the prior consent in writing of the Lender and the Mortgagor shall not create or purport to create any lease or tenancy or accept any surrender thereof otherwise than under the said powers."

Fennell v. N17 Electrics

11. The judgment of Dunne J. in *Fennell v. N17 Electrics* [2012] IEHC 228 is particularly relevant to this case. That case concerned a similar claim where it was argued that a lease took priority to the interest of the receiver. It is relevant to note what Dunne J. states at para 34 of that judgment:

> "Counsel for the respondent referred to a number of factual matters. First of all, he pointed out that the respondent was in occupation of some of the premises prior to the first mortgage. Therefore, in those circumstances, he submitted it would not have been possible for the mortgagor to get prior written consent given that the tenancy was already in existence."

12. In this respect, Mr. McCourt's case is similar, since as is clear from Mr. Kenny's letter of 30th May, 2012 (which is prior to the date of the Mortgage Deed), while there is no reference to a formal lease or a tenancy agreement, there is a reference to rent being paid by Ashcliff to Mr. Mr. McCourt. However, Dunne J. rejected the claim that the lease took precedence over the bank's security in that case. Of relevance is her summary of the relevant authorities regarding the granting of leases by mortgagors at para 30:

> "A number of useful observations can be made from the authorities referred to above. I think, first of all, that it is clear that a mortgagor and mortgagee can expressly agree to exclude the power conferred by s. 18 of the Act of 1881. If the power is excluded, it may be done in a way that permits the mortgagor to grant a lease subject to the prior consent of the mortgagee. If such prior written consent is not obtained by the mortgagor and the mortgagor proceeds to enter into a lease with a tenant, the lease will be binding on the mortgagor as lessor, but as against the mortgagee, the lease will not be binding. It is also clear that in certain circumstances, the lease may be binding on the mortgagee in circumstances such as those described in the authorities referred, where, for example, the mortgagee "serves a notice on the tenant to pay the rent to him". It is also clear from the authorities referred to above, that the mere fact that the mortgagee is aware of the existence of a tenancy and that a tenant is paying rent to the mortgagor which is being used to pay the obligations of the mortgagor to the mortgagee, is not, of itself, sufficient to create a relationship between the mortgagor's tenant and the mortgagee."

13. In the circumstances of this case, it is critical therefore to observe that, in light of *Fennell v. N17*, the mere fact that Anglo might have been aware that Ashcliff was paying rent to Mr. McCourt, with the consequent suggestion that Anglo was or should have been aware of the existence of a tenancy between Mr. McCourt and Ashcliff, is not sufficient to grant Aschcliff's lease priority over Anglo's security. It is clear from *Fennell v. N17* that something considerably more is required, such as Anglo serving notice on Ashcliff to pay rent to it. Nothing of this nature occurred in the present case.

14. On the contrary, the evidence that has been adduced regarding matters prior to and at the time of the grant of the mortgage would make it difficult for this Court to conclude that there was any consent by Anglo to the lease by Mr. McCourt of the two guesthouses such that the said lease took priority to Anglo's security. In particular, there were requisitions on title in respect of both guesthouses dated 30th July, 2002, signed on behalf of Mr. McCourt by his solicitor which expressly deny the existence of a lease in the most unequivocal terms and thus make the claim by Mr. McCourt that Anglo consented to the existence of a lease particularly difficult to support. These replies to requisitions, insofar as relevant, state:

"5. Confirm the Borrower is in sole possession of the land. **Confirmed**

6. If there any other person other than the Borrower in occupation of the premises? If so, please furnish details.
Temporary/Hostel/Bed & Breakfast

7. If the property or any part of it is let, please furnish the Lease or Tenancy Agreement. If not in writing, state and prove the terms of the Tenancy. No.

50.5.1. Is the property being disposed of the subject of leasehold interests created by the Vendor or its predecessors or have any such leasehold interests previously existed since 1st November 1972? **No**

50.5.2. Where there are any Vatable leasehold interests in the property […] **None such**".

But this is not all, because in the first Facility Letter dated 19th June, 2002, sent by Anglo to Mr. McCourt (and repeated in the Facility Letters dated 15th November, 2007, and 5th November, 2008, which replaced the first Facility Letter) it is explicitly stated that the funds were being lent to Mr. McCourt on condition that he provide a first legal mortgage over the two guesthouses:

> "Further to our recent discussions Anglo Irish Bank Corporation plc (the "Bank") is pleased to confirm its willingness to make available to Mr. Ronald McCourt (the "Borrower") a Loan Facility (the "Facility") on the terms and conditions set out in the General Conditions and this facility letter […]
>
> 3. Security
>
> (a) A first legal mortgage over:

(i) Warrington Bed & Breakfast, 10 Warrington Place, Dublin 2;

(ii) Harrington House, 21 Harrington Street, Dublin 2; (collectively known as the "Properties")".

15. If Mr. McCourt were to be successful in his argument that Anglo's receipt of Mr. Kenny's letter, without demur on its behalf, amounted to Anglo consenting to the existence of the lease, then this would fly in the face, not only of Mr. McCourt's replies to requisitions in which he states that there is no lease but also it would fly in the face of the commitment by him to provide a first legal charge over the guesthouses. This is because this commitment by Mr. McCourt could only be understood by Anglo to mean that there was no interest taking priority to Anglo's charge, whether a lease to Aschcliff or otherwise.

16. It is also relevant to note the express wording of Clause 6 of the Mortgage Deed states that Mr. McCourt will not *'permit to subsist'* any lease on the two guesthouses. This Court interprets this expression as meaning that if there was a lease in existence at the time the Mortgage Deed was signed, as alleged on behalf of Mr. McCourt, that Mr. McCourt would bring this lease to an end. It is clear that Mr. McCourt failed to do so, since his entire case is based on this lease continuing to subsist both before and after he signed the Mortgage Deed. It was entirely reasonable for Anglo, on the 12th August, 2002 the date when the Mortgage Deed was signed by Mr. McCourt, even if it knew on the 30th May, 2002, that there was an oral tenancy between Mr. McCourt and Ashcliff, to rely on Mr. McCourt's undertaking pursuant to Clause 6 of the Mortgage Deed not to allow any lease to continue to exist over the two guesthouses. For this reason, this Court does not accept that Anglo consented to the alleged oral lease, such that it would take priority over the bank's charge on the two guesthouses.

17. For all of these reasons and in reliance on *Fennell v. N17*, this Court concludes that the mere fact that Anglo was aware that Mr. McCourt was in receipt of rent from Ashcliff did not amount to consent by Anglo to the existence and the terms of a lease.

The bank was lax in its approach to the existence of a lease but something more is needed

18. While it could be said that Anglo was lax in its dealings with Mr. Kenny in the sense that the existence of a lease was certainly implicit in his letter, it is clear from Dunne J.'s judgment in *Fennell v. N17* that the laxness of Anglo would not be sufficient to constitute consent to the existence of a lease:

> "I also note the criticism of the bank's dealings with Mr. Naughton contained in Mr. McEvoy's affidavit. It does appear that the bank was somewhat lax in its approach to the question as to whether appropriate formal leasing arrangements were in place as between the borrower, Mr Naughton, and the company, given the requirements contained in the various letters of sanction. Having said that I am satisfied on the evidence before me that no prior consent, written or otherwise, was furnished by the bank to the 2005 business lease agreement. The fact that the company was in occupation of the premises did not mean that that a formal lease could not be put in place on terms which would have met the bank's requirements and therefore, presumably, would have received its consent."

19. This is particularly so in this case, since at least in *Fennell v. N17*, there was a written lease. In this case there is no reference to any written lease. It is therefore much more difficult for Mr. McCourt to sustain the argument that Anglo consented to uncertain lease terms, and regarding which no evidence was produced in Court (e.g. the length of the lease, the obligations of the lessee, the rights of the lessor etc.).

20. As noted by Peart J. in *Murphy v. Hooton* in which he relied upon Dunne J.'s judgment in Fennell v. N17, to reject the contention in the case before him that a lease took precedence over a bank's security, there was an even stronger case for rejecting such a proposition than in *Fennell v. N17*, since, as in the case before this Court, there was nothing except *'some verbal sort of arrangement'* in the case before Peart J at para 22:

> "It is hard to avoid the same conclusion in the present case, particularly in circumstances where there was not even a written agreement between the defendant and her husband and son, which might at least have stood some chance of containing terms which the bank might have given its approval to had it seen them. Here there is nothing except some sort of verbal arrangement whereby she agreed with her husband that each month she would pay the sum of €3250 against their obligations to the bank. […] In my view the evidence of acquiescence or even consent must be clear. It must be clear also exactly what the terms to which they are deemed to have accepted are. The effect of Clause 11(L) and clauses like it cannot be negated by stealth or accident. Where it is sought to imply by its conduct that the lender has acquiesced or given up its entitlement to the protection of such a clause, the facts must be clear so that an intention to do so is clearly made out, in circumstances where the need for a prior written consent is so clearly spelled out. The onus is on the defendant to establish these matters clearly."

Mr. McCourt, the controlling mind of Ashcliff

21. Even if this Court were wrong in its conclusions thus far, the alleged lessee in this case, Ashcliff, was at the relevant time 99% owned by Mr. McCourt and Mr. McCourt was a director of that company, so he was the controlling mind behind the company. This means that at the time when Mr. McCourt was signing a Mortgage Deed in which he covenanted that he would not *'permit to subsist'* a lease on the two guesthouses, he was also the controller of the company which had an oral lease with him as the landlord which breached this very covenant. In these proceedings, Ashcliff is seeking to rely on that lease to retain possession of the guesthouses in priority to the Receiver.

22. It is of course true that Ashcliff is a separate legal person to Mr. McCourt and so Mr. McCourt's undertaking, not to allow the existence of a lease, is not binding on Ashcliff as a matter of contract law. However, it cannot be ignored that the controlling mind of Ashcliff is Mr. McCourt and more importantly that he borrowed funds from Anglo on the back of his undertaking, as mortgagor in the Mortgage Deed, not to allow a lease to subsist over the guesthouses Yet Ashcliff is saying, in its defence to the Receiver's action for possession, that it is entitled to benefit from the lease which that company entered, on the grounds that it is a *'stranger'* to the covenant given by Mr. McCourt, that he would not allow a lease to subsist, even though Ashcliff was controlled by Mr. McCourt.

23. In light of these circumstances, the Supreme Court case *Re: Salthill Properties Limited* [2006] IESC 35 is particularly relevant. In that case, a receiver sought a direction that a lease entered into by a company, Potteridge, contravened a negative pledge clause contained in a mortgage deed. The clause in question was in similar terms to Clause 6 of the Mortgage Deed in this case, since it prohibited the creation of a lease without the prior consent of the bank. Despite this negative pledge, a lease was entered into with Potteridge over the mortgaged properties. In the High Court, Laffoy J. cited a passage from *Gough on Company Charges* (2nd ed, 1996) which states:

> "Although creating no more than a negative contractual right, a restrictive clause can affect the quality of, and therefore

> bind, a subsequent proprietary interest through actual notice of the restriction. In equity it would be unconscionable to permit a subsequent third party to take his interest free of the restrictive right in spite of his actual knowledge that to do so would constitute a breach of the floating charge contract by the chargor."

24. In this case, the same issue arises, namely whether it would be unconscionable to pemit Ashcliff, a company controlled by Mr. McCourt to maintain that its lease of the two guesthouses takes priority over the negative pledge given by Mr. McCourt in the Mortgage Deed in spite of the actual knowledge of the controlling mind of the company of that negative pledge.

25. In the Supreme Court, McCracken J. noted that Potteridge accepted that the onus of proof was on it to show that it did not have actual knowledge of the negative pledge clause in that case, but Potteridge nonetheless alleged that it satisfied this onus by virtue simply of the fact that Potteridge was a separate legal person from the borrower, in that case a company called Salthill Properties Limited. This was rejected by the Supreme Court which found that the lease did contravene the negative pledge clause on the basis that no evidence was adduced to satisfy this said onus of proof upon Potteridge other than a bald assertion that it was a separate legal person to the borrower. Similarly in this case, no evidence was adduced on behalf of Ashcliff that Ashcliff was not on actual notice of the negative pledge clause and accordingly this Court concludes that Ashcliff was on notice that Mr. McCourt was prohibited from allowing a lease to subsist over the two guesthouses and on this basis it would be unconscionable to allow Ashcliff to claim that this lease that it so entered takes priority over the interest of the Receiver. Thus, on this ground also this Court would conclude that the lease does not take priority over the interest of the Receiver in the two guesthouses.

Commercial realties

26. Finally, while in no way determinative of the result in this case, it remains to be observed that the reason why the conclusion reached by this Court makes not just legal sense but also commercial sense is highlighted by Dunne J. when she made the same point in the *Fennell v. N17*. At paragraph 47 she stated:

> "It is essential from a lender's point of view that the secured property is available as security in the event of default by the borrower. It is therefore important to ensure from the lender's point of view that any impediment to the realisation of its security by reason of a lease binding on the mortgagee should be one in respect of which the mortgagee had furnished its consent. That is the importance and the function of the negative pledge clause contained in the various mortgages/charges. From the bank's point of view in this case, there was no commercial reality apparent in the business lease agreement. It is inconceivable that the bank would ever have consented to a lease in the terms of the business lease agreement had it been asked to do so. Its conduct in granting loans from time to time without appropriate leases having been put in place does not alter the position."

27. Similarly, in this case, it is inconceivable that Anglo would lend €1.25 million and then consent to the terms of a lease which render its security for those borrowings useless.

28. Finally, sometimes the legal niceties of these types of claim divert attention from the true circumstances, namely Mr. McCourt borrowed €1.25 million from a bank and gave security over two very valuable properties in order to induce the bank to lend to him. Furthermore, in order to get the funds, he represented to the Bank (through his solicitor) that there was no lease on the properties. He also undertook to provide a first legal charge to the Bank under the terms of his loan agreement, meaning that no other interest would have priority over the Bank's legal charge. It is clear to anyone with any knowledge of commerce that a bank would not, save in the rarest of situations, lend money on the back of security unless it had a first legal charge over the secured property (i.e. that a lessee did not have priority over the interest of the bank). This was also confirmed in evidence given in this case on behalf of Anglo.

29. Mr. McCourt duly defaulted on this loan (and indeed defaulted on his agreement to the pay the rent to the bank after the proceedings issued). Despite the foregoing circumstances he now seeks to claim that his own company was a tenant in the properties with the consent of the bank which, if upheld by this Court, would mean that Mr. McCourt would have obtained a €1.25 million loan from the bank while effectively giving the bank a worthless security. Mr. McCourt seeks to leave the bank high and dry while walking away in possession of the premises through his company (albeit that his shareholding in the company is less than 99% now) and in possession of the rent of those premises as the landlord.

30. It remains to be observed that if it were that easy for a borrower to borrow funds, fail to repay them and then continue to use, through his company, the secured property and retain the rent, it would be a very significant disincentive to banks to engage in commercial lending.