Neutral Citation Number: [2012] IEHC 435

THE HIGH COURT

COMMERICAL

[2010 No. 7215 P]

[2011 No. 79 COM]

BETWEEN

ACC BANK PLC.

PLAINTIFF

AND

FRIENDS FIRST MANAGED PENSION FUNDS LIMITED, SEAN LYNE AND NOEL CONNELLAN

DEFENDANTS

JUDGMENT of Ms. Justice Finlay Geoghegan delivered on the 26th day of October 2012

1. This judgment is given in the claim brought by the plaintiff ("ACC") against the first named defendant, Friends First Managed Pension Funds Ltd. ("Friends First"). A judgment on consent has already been given on 11th October, 2011, against the second named defendant ("Mr. Lyne") and the third named defendant ("Mr. Connellan").

2. Correctly, no reliance was placed in the course of the claim against Friends First on the consent judgment given against Mr. Lyne and Mr. Connellan.

3. ACC is a licensed financial institution and a subsidiary of Rabobank Nederland. Friends First is a regulated life insurance company in Ireland. Its portfolio of business includes unit link funds including property funds. The claim in these proceedings arises out of a facility given by ACC to the defendants in connection with one such fund.

4. The issues in the proceedings primarily relate to the proper construction of the facility letter issued on 30th October, 2007 and accepted by the defendants on 13th November, 2007 ("the Facility Letter").

5. Both parties are in agreement that the Facility Letter, being a commercial document, should be construed in accordance with the well known principles set out in this jurisdiction by Geoghegan J. in the Supreme Court in *Analog Devices B. V. v. Zurich Insurance Company* [2005] IESC 12, [2005] 1 I.R. 274, at p. 280, where he cited with approval the principles set out by Lord Hoffman in *ICS v. West Bromwich BS* [1998] 1 WLR 896, at p. 912:

> "(1) Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.
>
> (2) The background was famously referred to by Lord Wilberforce as the 'matrix of fact' but this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the parties and to the exception to be next mentioned, it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.
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> (3) The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way we would interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear. But this is not the occasion on which to explore them.
>
> (4) The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammar; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable man to choose between the possible meaning of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must for whatever reason, have used the wrong words or syntax; see *Mannai Investment Co. Ltd. v. Eagle Star Ass. Co. Ltd.* [1997] A.C. 749.
>
> (5) The 'rule' that words should be given their 'natural and ordinary meaning' reflects the commonsense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had. Lord Diplock made this point more vigorously when he said in *Antaios Compania S.A. v. Salen A.B.* [1985] 1 A.C. 191, 201:
>
> 'If detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business commonsense, it must be made to yield to business commonsense'."

6. The evidence given in these proceedings included both the admissible background and also in some instances the previous

negotiations of the parties and declarations of subjective intent. There is no application for rectification in these proceedings and, accordingly, I do not propose referring to and have not taken into account evidence which falls within that excluded category.

Background to the Facility Letter
7. In 2006, Friends First established the Crystal Property Development Fund ("the Crystal Fund"). The Crystal Fund was a unit-linked fund. A unit-link fund was explained, without dispute, as one where the rewards for the customer are linked to the pool of assets which the insurance company keeps in a separate account for the benefit of the unit-linked investors in that fund. All assets are registered in the name of the insurance company, but the insurance company must retain and account for them separately for the individual investors and this separation requirement is prescribed by the regulatory regime governing unit-linked funds.

8. Friends First acted as the arranger of the Crystal Fund which was an Irish geared property development fund with Crystal Partners Ltd. ("Crystal Partners") as the investment manager. The principals of Crystal Partners were Mr. Lyne and Mr. Connellan who were experienced property investors and developers. They were the owners of significant property interests in 2006.

9. Following the launch of the Crystal Fund in the summer of 2006, €35.9m was available for investment. In addition, the parent company of Friends First, Friends First Life Assurance Company Ltd. added €5m by way of a strategic investment making a total initial investment pool for the linked fund of €40.9 million.

10. The focus of the investment was the acquisition of a portfolio of "brownfield" sites outside of the Dublin Metropolitan Area. The Crystal Fund had indicated from the outset that it proposed financing the site purchases with a combination of equity and "limited recourse (secured by the land) bank debt".

11. Unit-linked funds operated by regulated insurance companies in Ireland do not have their own legal status. The commitment to incoming investors in these funds is that their policy values will be derived from the performance of the assets to which their fund is "linked", even though such assets are held in the name and ownership of the insurance company itself i.e. Friends First. Hence, borrowings taken in connection with the Crystal Fund, including the loan at issue in these proceedings, were taken in the name of Friends First rather than the Crystal Fund which has no separate legal personality. Similarly, the lands were held by Friends First.

12. ACC was first approached in May, 2006 by Crystal Partners as the investment manager for the Crystal Fund (Friends First) and Mr. Lyne and Mr. Connellan as co-owners in connection with a number of proposed acquisitions of property sites.

13. It appears that the basic business model had been established before ACC was approached. It involved Friends First and Mr. Lyne and Mr. Connellan buying as co-owners, using short-term facilities and equity to finance the project and having the project managed by Crystal Partners. During the loan term, rezoning and/or planning permission would be obtained, possibly, the issue of services also addressed, thereby adding significant value to the property which would then either be sold in whole or piecemeal, primarily as "ready to go" sites to be built out. It appears that the co-owners, referred to at times, as "the Friends First connection" did not rule out developing the properties themselves but this appeared unlikely.

14. The first facility sought from ACC related to property in Tullamore. It was granted on 1st November, 2006. It is not the subject of these proceedings. However, it is relevant that ACC and the defendants in these proceedings had negotiated and agreed several facilities in connection with the acquisition of brownfield sites by the co-owners with a similar business model prior to the Loan at issue in these proceedings. I am also satisfied that prior to concluding the agreement contained in the Facility Letter the subject matter of these proceedings, ACC and the defendants had established a general model for the form of facility which was dictated by and needs to be understood in accordance with the objective requirements of the business model of Friends First for the Crystal Fund and Mr. Lyne and Mr. Connellan and those of ACC as a prudent lender. On the evidence, I would summarise those requirements as including:

(i) Friends First required a non-recourse loan by reason of the nature of the unit-liked fund and the regulatory requirements relating to same.

(ii) The business model for which the lending was being given was the acquisition of brownfield sites, the adding of value to the site by rezoning or obtaining planning permission or otherwise during a limited time and a sale on out of which it was anticipated that the loan would be repaid and a profit generated for the co-owners.

(iii) It was inherent in the business model that the lands acquired were not income producing during the term of the loan and the anticipated added value of its nature was one where delays may occur prior to the sale.

(iv) The term "non-recourse loan" was used as meaning that there would be no recourse to the Crystal Fund i.e. Friends First for repayment of principal. ACC would have recourse to the lands which it would hold a security.

15. The facility agreed between the parties in relation to the Tullamore lands included provisions to deal with the above. It was subsequently used as the template for the subsequent facilities with each being considered and agreed in accordance with the facts applicable to the individual lands, including valuations, equity available, loan to value ratios, the location and planning or zoning prospects for each new parcel of land.

16. The loan the subject matter of these proceedings, referred to as the Gaurus Loan was the fifth such loan in the series of transactions. The application for it was made in July, 2007. The lands were made up of four separate sites in County Clare. Some had been previously purchased by Mr. Lyne and Mr. Connellan and financed by AIB and further portions were now being purchased. Contracts had been entered into but the vendors remained the registered owners. The total purchase prices were €29.8m and costs estimated at €750,000.

17. The Facility Letter was issued on 30th October, 2007, and accepted on 13th November, 2007. It was varied by agreement by the addition of paragraph 8(d) on 21st November, 2007. The Facility was drawn down on 21st November, 2007. The Facility was offered on the terms set out in the Facility Letter (in which Friends First is referred to as "the Fund") and the General Terms and Conditions. The terms of the Facility Letter (as amended) relevant to the disputes include the following:

"***1. The Borrower***

Sean Lyne, Noel Connellan and the Fund (collectively 'the Borrowers' or 'the Members' and 'Member' means anyone of the Members).

2. Amount

The Facility is an amount of up to €25,250,000.00.

3. Term

The Facility is for a term of 18 months from the date of the first drawdown of the Facility unless a demand for earlier payment is made in accordance with clause 6 below.

4. Purpose

The purpose of the Facility is to discharge AIB Bank debt of the Borrower secured on 33 acres at Gaurus, Ennis, Co. Clare ("the AIB Facility") and acquire a further 61 acres at Gaurus, Ennis, Co. Clare (together "the Lands") and to fund the Bank's handling charge of €250,000.00.

5. Drawdown

The Facility will be issued as a single advance . . .

6. Repayment

Notwithstanding clause 3 above, the Facility shall be repayable immediately on demand being made by the Bank on the Borrower. Unless and until such demand is made (and without limiting the Bank's right to demand immediate repayment of the Facility at any time) interest shall roll up on the Facility until the amount of interest rolled up and capitalised reaches €3,200,000.00 and the Borrower shall pay all interest charged to the Facility in excess of this amount of €3,200,000.00 within 14 days of it being charged.

Notwithstanding the foregoing, the Facility (including all rolled up and capitalised interest) will in any event be repayable when the Lands are sold, or when the term of the loan referred to at clause 3 above expires, whichever is the earlier. Furthermore . . .

7. Interest

Interest will be charged on the Facility, in accordance with the provisions of the General Terms, by reference to three month Interest Periods at a rate for each Interest Period which is the aggregate of:

1. 2 per cent per annum; and

2. EURIBOR for that Interest Period.

8. Security

The Facility shall at all times be secured by the following security (the '***Bank's Security'***):

(a) a limited recourse guarantee (in respect of the entire of the liabilities of the Borrower to the Bank) from the registered owners of the Lands secured by a limited recourse first legal mortgage/charge over the said registered owners' interests in the Lands;

(b) a mortgage/charge over the Borrower's equitable interests in the Lands.

(c) An assignment, by way of Mortgage in favour of the Bank, by the Borrowers of their respective interests in the Contracts pursuant to which they have contracted to acquire the Lands from the aforesaid registered owners.

(d) A first legal mortgage/charge over property adjoining the lands comprising a house on 0.181 acres in the ownership of the Borrowers.

9. Additional Conditions Precedent

In addition to the conditions precedent specified in the General Terms, the following conditions precedent must be fulfilled (to the satisfaction of the Bank) before the Borrower may draw down the Facility . . .

(a) . . .

(b) The Bank's solicitor to be satisfied with the legal structure being used in this case, ensuring the Bank has full recourse to the Lands in the event of default.

(c) . . .

(d) All Co-Ownership and partnership agreements for the transaction to be to the satisfaction of the Bank's Solicitor.

(e) . . .

(f) . . .

10. Liability of Members

10.1 While the liability of the Members in respect of the repayment of the Facility shall be joint and several, the Bank agrees, subject as set out in paragraph 10.2 hereunder, to limit its recourse (beyond the security set out at Clause 8 of this Facility) as to the repayment of the principal of the Facility and the payment of interest accruing under the Facility as follows:

(a) The Bank agrees to limit the liability of the Fund:

(i) as to the repayment of the principal of the Facility in the sum realised from the sale of the Bank's Security; and

(ii) as to the payment of all interest accruing from time to time under the Facility to 46.6% of all such interest.

(b) The Bank agrees to limit the liability of Sean Lyne and Noel Connellan:

(i) as to the repayment of the principal of the Facility to the sum of €22,000,000.00 (in respect of which sum, the said Sean Lyne and Noel Connellan shall be jointly and severally liable); and

(ii) as to the payment of all interest accruing from time to time under the Facility to 53.4% of all such interest (in respect of which interest, the said Sean Lyne and Noel Connellan shall be jointly and severally liable).

The Members shall be jointly and severally liable for the discharge of all other costs under the Facility (including any costs and/or penalties associated with terminating any fixed interest rate agreements).

10.2 The provisions of Paragraph 10.1 are expressly subject to the following provisions:

(a) the paragraph shall be construed so as to maintain and preserve the obligations secured by the Facility and the Bank's Security to the extent of the benefits, rights and proceeds arising under or in connection with this Facility and the Bank's Security and so as to maintain the security conferred thereby;

(b) the provisions of paragraph 10.1 shall not limit or restrict the recourse of the Bank to the Bank's Security in the event that (for any reason whatsoever) any of the documents comprised in the Bank's Security (or any of the right and remedies of any of persons thereunder is compromised or) is not fully valid, binding or enforceable and the Borrower (or any of the Members) fails or refuses to execute such further documents as the Bank may reasonably require to rectify such defects.

(c) nothing herein shall prevent the Bank from obtaining a declaratory or similar judgment or order as to the obligations of any one or more of the Members under the Bank's Security or to claim or prove in any bankruptcy, insolvency, reorganisation or arrangement to the extent that such a claim or proof is a necessary procedural step to enable the Bank fully to realise the benefits of its rights and remedies under the Bank's Security;

(d) subject to the above and the provisions in paragraph 10.1, nothing herein contained shall derogate from or otherwise limit the right of recovery, realisation or application of the proceeds of realisation of the Bank's Security by the Bank under this Facility or the Bank's Security as if the liability of the Borrower under the Facility was entirely joint and several.

(e) subject to the above and the provisions in paragraph 10.1, in the event that the Bank shall demand of the Borrower in writing repayment, when due, of the entire of the Facility (including any accrued but unpaid interest to the date of such demand), nothing herein contained shall prohibit the Bank from proceeding against the Members prior to realising some or all of its Bank's Security or vice versa.

(f) the entire of the limitations in provisions in paragraph 10.1 shall lapse in the event that any of the provisions of the Borrower's Co-Ownership Agreement shall be materially varied (whether orally or in writing or otherwise by action) by the Members without the prior written consent of the Bank.

(h) In the event that the Borrower or any of the Members shall challenge the Bank's Security under the Facility (or the release by the Bank of any of the same) then the liability of the Members under the Facility shall be entirely joint and several, without limitation, and provisions in paragraph 10.1 hereof shall cease to apply.

(i) In the event that the Borrower shall vary the provisions of and/or release any other party to any of the assets comprising the Bank's Security (without the prior consent in writing of the Bank, which consent will not be unreasonably withheld) then the liability of the Members under the Facility in respect of the Loan shall be entirely joint and several, without limitation, and provisions in paragraph 10.1 hereof shall cease to apply.

(j) the limitations on liability contained in paragraph 10.1 hereof shall, to the extent specified below, cease and be of no effect if any Member(s):

(1) . . .

(2) . . .

(3) . . .

(4) . . .

(5) commits fraudulent or wilful misconduct or is grossly negligent in connection with the Facility, the Bank's Security or the Lands.

. . .

The General Terms

Unless expressly excluded or varied by the terms of this Letter, the General Terms shall apply to the Facility. If there is any conflict between the terms of this Letter and the General Terms the terms of this Letter shall prevail. Certain expressions used in this Letter are defined in the General Terms."

Facts Leading to Claim

18. On 13th November, 2007, Friends First, Mr. Lyne and Mr. Connellan and Crystal Partners entered into four similar co-ownership agreements in relation to the four separate parcels of land which made up the total Gaurus lands. Crystal Partners joined as the person appointed under an investment management agreement to manage the property on behalf of the co-owners in accordance with the terms of the agreement.

19. Each of the agreements recited the agreement to purchase for a specified sum and then included amongst the Recitals:

"B. The Co-Owners have mutually agreed to contribute and to be responsible for the costs of acquisition of the Property, the costs associated therewith and the costs of making a planning application to develop the property in proportion to each Co-Owners proportionate share as set out in the Second Schedule hereto (hereinafter called the 'Proportions').

C. The Co-owners have mutually agreed to partly finance the purchase and to develop the Property by way of a loan (hereinafter called 'the Loan') from ACC Bank dated 30th October, 2007 (hereinafter called the 'Bank') and each Co-Owners has agreed to execute a First Fixed Charge over its interest in the Property in favour of the Bank as a security for the Loan and it is hereby mutually agreed between the Co-Owners that the Loan and security for any further borrowings to develop the Property shall be limited to the extent detailed in the Loan Offer."

20. The provisions of each of the co-ownership agreements included the following clauses relevant to the claim herein and issues in dispute:

"1. The Co-Owners shall hold the Property (together with any premises erected thereon) in the Proportions as set out in the Second Schedule hereto and subject to the rights and powers declared in this Agreement.

2. The parties shall contribute to the repayments of the principal and interest in respect of the Loan in the Proportions.

. . .

7. The Co-Owners (and each of them) ***HEREBY COVENANT*** with each other

. . .

7.2 They will at all times observe and perform all restrictions, covenants, conditions and stipulations affecting the Property including the conditions and covenants imposed by the Loan, and the Planning Permission, as the case may be.

. . .

12. The following general provisions shall apply:

. . .

12.6 The Agreement (together with all documents required by its terms to be entered into by the parties) sets forth the entire Agreement and understanding between the parties and the arrangements described herein.

12.7 None of the parties hereto shall assign any of their respective rights or obligations under this Agreement nor any of the documents referred to herein (in this Agreement) in whole or in part save with the other parties written consent and the consent of the Bank as appropriate (such consent not be unreasonably withheld)."

21. In each of the agreements, the proportions in the Second Schedule were:

1. Friends First Managed Pension Funds Ltd. : 46.6%
2. Noel Connellan: 26.7%
3. Sean Lyne: 26.7%

22. A copy of each of the co-ownership agreements certified by the solicitors acting for the co-owners, McMahon O'Brien Downes, solicitors on 15th November, 2007, was sent to Harrison O'Dowd, solicitors, acting for ACC. As appears from paragraph 9(d) of the Facility Letter, all co-ownership and partnership agreements for the transaction had to be to the satisfaction of ACC's solicitors. Mr. O'Dowd prepared a witness statement, which was agreed, and he did not give oral evidence in which he refers to receipt of the certified copies of the co-ownership agreements. It is presumed that he was satisfied with the contents of same as there was no evidence of any objection and the money ("the Loan" or "Facility") was drawn down on 21st November, 2007.

23. The total cost of the properties purchased was €29.8 million. The amount of the Facility was €25.25m, of which €0.25m was in respect of fees for ACC. It is not in dispute that notwithstanding Recital B to the co-ownership agreements, the balance of €4.8m (plus perhaps some additional element in respect of costs) was funded exclusively by Friends First. The evidence is that ACC was aware that Friends First was providing the additional cash as equity. Two explanations were given for the fact that Mr. Lyne and Mr. Connellan did not provide their respective proportions of the additional equity required. First, that they had agreed to give what was termed "a guarantee" in relation to the Facility connected with the gearing of the Crystal Fund, but which, in accordance with paragraph 10.1(b) of the Facility Letter, is more accurately an acceptance of a joint and several personal liability up to a limit of €22m for the repayment of the principal of the Facility. Secondly, it was suggested by Mr. Browne of Friends First, in evidence, that it was by reason of a cashflow issue. The reasons for the arrangement do not appear relevant. I am satisfied as matter of fact that Friends First contributed the entire of the additional cash required at the time of discharge of the AIB loan and acquisition of the additional lands of approximately €4.8 million. It is also a fact that Mr. Lyne and Mr. Connellan, in the Facility Letter, undertook personal liability to ACC for principal in the sum of €22m, which is well in excess of their respective proportions of 26.7% in the co-ownership agreements. Further, I am satisfied that it is the exclusive equity contribution by Friends First and so-called guarantee which gave rise to the supplemental agreement entered into between Friends First and Mr. Lyne and Mr. Connellan.

24. A copy of a signed but undated supplemental agreement between Mr. Connellan, Mr. Lyne and Friends First was produced in evidence. Mr. Browne, who was one of the signatories on behalf of Friends First, gave evidence, which I accept, that it was signed in December, 2007 but he could not state on what date. In its definition section, it refers to "Co-Ownership" as meaning "the Co-Ownership Agreement of even date between the parties in respect of the Lands". The Lands are the four parcels of properties in respect of which the four co-ownership agreements were entered into on 13th November, 2007.

25. Mr. O'Brien, solicitor for the co-owners, gave evidence that he drafted the supplemental agreement on the instructions of the defendants and sent same to Crystal Partners for execution by the parties. I have concluded, by reason of the above definition, that as a matter of probability, it was drafted by Mr. O'Brien at the same time or shortly after he prepared the co-ownership agreement.

The Loan sanction is defined as meaning "the loan offer issued by ACC Bank on 30th October, 2007". It makes no reference to the acceptance of the Facility Letter, and hence, it appears probable that it was prepared prior to 13th November, 2007. The supplemental agreement provides:

"**RECITALS**:

1. **The parties have AGREED** to enter into this Supplemental Agreement to govern their respective liability on the Loan Sanction.

NOW THIS AGREEMENT WITNESSETH as follows:

1. NC and SL shall guarantee the liability of FF to the Bank

2. In respect of the **TWENTY FIVE MILLION TWO HUNDRED AND FIFTY THOUSAND EURO (€25,250,000)** loan being borrowed from the Bank pursuant to the Loan Sanction, the parties shall be responsible to repay the interest and principal of that loan in the amounts set opposite their names hereunder.

NC and **SL** : €15,753,000.00

FF : €9,247,000.00

3. **NC** and **SL COVENANT** with FF and FF **COVENANTS** with NC and SL to comply with their obligations set out in paragraph 2 above and each party **COVENANTS** to indemnify the other against an non-payment or non-observance.

4. Parties acknowledge figures in Clause 2 may vary slightly to take account of Bank Fees and Bank legal fees."

26. It is agreed between ACC and Friends First that the above amounts in percentage terms is that Mr. Connellan and Mr. Lyne were responsible for 63.012% and Friends First 36.988%.

27. The supplemental agreement was not notified to ACC in 2007 and its consent was not sought to any variation to the co-ownership agreements.

28. The first information given by Crystal Partners to ACC in relation to an agreement between the co-owners that they be responsible for a differing percentage of the Loan to that in the co-ownership agreement was in July, 2008. Mr. Crowe, a senior manager in the Special Asset Management Division of ACC in Limerick with responsibility for these loans, gave evidence that in June, 2008 one of his colleagues, Ms. Sinead Kennedy, raised a query with David Dunne of Crystal Partners in relation to a figure in cashflow projections furnished, in response to which she was informed of "a side agreement" between Mr. Connellan, Mr. Lyne and Friends First for the Loan to be split as to €15.753m for Mr. Connellan and Mr. Lyne and €9.248m for Friends First. It does not appear that ACC at that time raised any further query in relation to the existence of a side agreement with a split which was not consistent with a Friends First responsibility for 46.6% of the Facility which ACC had estimated at €11.5 million.

29. ACC conducted an annual review of the Facility in November, 2008 and raised queries with Crystal Partners, again, Mr. Dunne, with whom they dealt in relation to the Facility. On receipt of Mr. Dunne's responses, Mr. Crowe, by an email of 20th November, 2008, said to Mr. Dunne:

"Many thanks for the reply. Just one small point - We have no record of a Bank consent to amend the shareholdings in the Gaurus lands, in fact all of our documentation reflects the original proposal. How was this change handled? Was it part of the co-ownership agreement or a later agreement?"

30. In response to this query, Mr. Dunne sent to Mr. Crowe a copy of the signed supplemental agreement and the following email on 21st November, 2008:

> "Liam,
>
> Further to your query below please find attached the signed Supplemental Agreement which states the percentage holdings of the ACC Loan are as follows:
>
> • NC/SL 63.012% (€15.753 Million)
>
> • Fund 36.988% (€9.247 Million)
>
> In order to ensure the fund got a high gearing level Noel & Sean agreed to provide personal guarantees for €22 million of the €25 million facility. In return for this they received finance for 100% of their interest in the lands which gave the fund a gearing of in excess of 67%. This proposal is the same as the one agreed on Cavan and ensures that the investors in the fund get a superior return on their money invested.
>
> If you have any queries please contact Rory or myself.
>
> Kind regards,
>
> David."

31. The only response was by email: "Thanks David, Have a good weekend, Liam".

32. On the evidence, I am satisfied that ACC, from 21st November, 2008, was aware of the terms of the supplemental agreement (it had a copy) and did not raise any further query or any objection to the fact that such agreement had been entered into between Friends First, Mr. Connellan and Mr. Lyne. As appears from the email exchange, the query from Mr. Crowe related to the "Bank consent to amend the shareholdings in the Gaurus lands". As set out later, the supplemental agreement does not amend the percentage holdings in the Lands.

33. In November, 2008 the Facility was regarded as a performing facility by ACC. In accordance with its terms, interest was being rolled up and no payment was required from any party. The term of the Facility was due to expire on 21st May, 2009. By this stage,

the property market was in difficulty. The anticipated progress and potential sales of the Gaurus lands had not been achieved. By a letter of 6th May, 2009, ACC wrote a formal letter addressed to Mr. Lyne, Mr. Connellan and Friends First, care of Crystal Partners, identifying the total due on 21st May, 2009, as €27,694,323.45 and stating:

"The above amount falls for payment on the due date outlined above. Please arrange for payment of this amount on or before this date. You should note that, in the event of late payment, interest will be charged at 0.5% per month above the rate otherwise applicable to the facility. If you have any queries, please contact us at . . ."

34. No payments were made. In evidence, Mr. Crowe confirmed that this letter was not pursuant to any decision to call in the Loan. There were negotiations throughout the summer of 2009 in relation to the extension of the Facility and other facilities relating to the Crystal Fund. On 24th September, 2009, a further letter was written by ACC to Mr. Lyne, Mr. Connellan and Friends First, identifying the total arrears as being the same figure, stating that the account had moved into arrears on 21st May, 2009, setting out a surcharge interest rate of 6% per annum and a standard interest rate of 3.914%. The interest arrears are stated to be €374,187.49 and surcharge interest of €573,613.93. The letter then states:

"Dear Sir/Madam,

I refer to the above loan facility. Please note that the account is currently in arrears by the amount quoted above, which is the amount of interest outstanding from the date the last payment was made on the account. Based on our calculation, the pro-rata amount of interest due and payable by each party is as follows:

Borrower	***Holding***	***Interest***	***Surcharge***
FFMPFL	46.60%	€174,371.37	€267,304.09
NC & SL Jointly	53.40%	€199,816.12	€306,309.84
Total		€374,187.49	€573,613.93

Please make arrangements for the arrears to be cleared in full within 14 days of the date of this letter.

. . ."

The letter was signed by Mr. Crowe and a Mr. Noonan, also of Special Asset Management. The respective percentages are those set out in clause 10.1 of the Facility Letter.

35. The total amount demanded was not paid. On 12th October, 2009, Friends First made a payment of €138,404.47 directly to ACC. There was some dispute as to the basis of that payment. Mr. Browne of Friends First, in evidence, explained it as being a payment made by Friends First as a goodwill gesture in advance of an anticipated meeting with Mr. Crowe in relation to the extension of this facility and a number of other facilities relating to the Crystal Fund. However, his evidence also was that he got Crystal Partners to run some figures for interest. I find that it was an amount paid by Friends First in respect of the interest (excluding the surcharge interest) claimed in the letter of 24th September, 2009, calculated on the basis of 36.988% of the total rather than the 46.6% specified in the letter of 24th September, 2009. Mr. Browne had obtained a note of the amount from Crystal Partners. This payment was made directly by Friends First to ACC. I accept the evidence of Mr. Browne that payments in respect of the properties and loans in the Crystal Fund were normally made through the Crystal Partners, however, on this occasion, it was made directly to Friends First. Further, I find that whilst the payment made was in respect of interest claimed form 21st May, 2009, it was also intended to facilitate further negotiations at an anticipated meeting with Mr. Crowe. Payments were also made by Friends First in respect of other Crystal Fund facilities with ACC at that time. The ongoing negotiations related to several facilities.

36. ACC and Friends First failed to reach agreement on an extension or restructuring of the facilities granted by ACC in respect of the Crystal Fund, including the Facility the subject matter of these proceedings. By a letter of 24th November, 2009, Mr. Crowe informed Mr. Browne that ACC's credit committee was not prepared to agree to the restructuring and indicated that "the Bank will immediately seek to protect its position". He then stated, "ACC Bank will continue to demand interest in respect of all the facilities according to the recourse set out in each individual loan. Interest continues to accrue at surcharge levels. We will correspond on each individual loan in the coming days". Evidence was not given of any subsequent correspondence in 2009 in relation to the Facility.

37. On 1st April, 2010, ACC, through its solicitors, Messrs. McCann Fitzgerald, made a formal demand for repayment and contended that the defendants were in breach of clause 10.2 of the Facility Letter and, accordingly, jointly and severally liable for the entire amount of the Facility and all interest accruing thereon and demanding same. These proceedings were commenced on 27th July, 2010.

Issues

38. The issues in the claim against Friends First at the end of the hearing may be summarised as follows:

(i) Did the limitation on recourse to Friends First pursuant to paragraph 10.1(a) of the Facility Letter lapse pursuant to clause 10.2(f) by reason of a material variation to the "Borrower's Co-Ownership Agreement" by Friends First and Mr. Lyne and Mr. Connellan entering into the Supplemental Agreement or by the action of Friends First in making a payment to ACC in October 2009, in respect of interest calculated at 36.988% rather than 46.6%.

(ii) If it did not so lapse, did it lapse pursuant to paragraph 10.2(j)(5) of the Facility Letter by wilful misconduct of Friends First in May or October, 2009 in failing to pay the full interest allegedly due by it.

(iii) If the limited recourse provisions in paragraph 10.1(a) did lapse, is ACC now estopped from or has it waived its right by reason of election to pursue a claim against Friends First other than in accordance with the limited recourse provisions.

(iv) If the limited recourse provisions in paragraph 10.1(a) have not lapsed, what is the extent of Friends First's liability for interest on the Facility? In particular:

(i) is it liable for 46.6% of the interest which accrued during the term of the Facility and rolled up;

(ii) is it liable for 46.6% of the interest accruing after the expiry of the term of the Facility, and if so, for how long;

(iii) is ACC entitled to recover surcharge interest or is it a penalty, and if so, for what periods.

Material Variation - Supplemental Agreement
39. The evidence of several of the witnesses called on behalf of ACC makes clear that there was a misunderstanding by it and them of the effect of the supplemental agreement. They appear to have understood that it either changed the co-owners' respective proportionate interests in the Lands or in their liability to ACC for principal or interest on the Facility. Construing the co-ownership agreements and the supplemental agreement in accordance with the terms of each, my conclusions are as follows.

(i) The supplemental agreement did not change in any way the percentages in which the co-owners held each of the Properties pursuant to the co-ownership agreements.

(ii) The supplemental agreement did not change in any way the obligations of the co-owners pursuant to the agreements in relation to the Properties.

(iii) The supplemental agreement did not change in any way the liability of each of the co-owners to ACC as set out in the Facility Letter, either in respect of the payment of principal or in respect of the payment of interest. The supplemental agreement was an agreement only between the three co-owners. As a contract between those parties, it could not and did not alter or vary in any way the obligations undertaken by each to ACC in the agreement constituted by the accepted Facility Letter.

(iv) The supplemental agreement did change the agreement between the co-owners recorded at clause 2 of the co-ownership agreements that they should, as between themselves, contribute to the repayments of principal and interest in respect of the Loan i.e. the facility from ACC in the proportions set out in the Schedule to the co-ownership agreement i.e. 46.6% for Friends First and 26.7% for each of Mr. Lyne and Mr. Connellan. The figures included at paragraph 2 of the supplemental agreement are such that the proportions in which Mr. Connellan and Mr. Lyne were now agreeing, as between themselves and with Friends First, jointly, to take responsibility for the repayment of interest and principal was 63.012% and that of Friends First, 36.988%.

(v) The agreement between the co-owners recorded at paragraph 2 of the co-ownership agreement that they shall contribute to the repayments of principal and interest in respect of the Loan in the Proportions (i.e. 46.6% for Friends First and 26.7% for each of Mr. Lyne and Mr. Connellan) itself already differed from each of the co-owners' obligations to ACC as set out in the Facility Letter, both in respect of the limited recourse provisions in clause 10.1 and the full, joint and several liability if that were to be lost.

40. It follows that the supplemental agreement varied clause 2 of the co-ownership agreement. The issue is whether or not the variation was material.

41. As already set out in this judgment, counsel for both parties were in agreement that the Court, in construing the Facility Letter, and in particular, clause 10, should do so in accordance with the principles approved of by the Supreme Court in *Analog Devices B.V. v. Zurich Insurance Company* [2005] IESC 12, [2005] 1 I.R. 274, and set out above. Further, counsel for both parties also referred the Court to a number of decisions in which the meaning of a material variation has been considered by the courts in the context of guarantees or contracts of suretyship. Counsel for Friends First submitted that whilst regard should be had to these decisions, that they must also be treated with some caution in the present context as the courts have made clear in a number of such decisions that the views expressed arise from the particular nature of a guarantee or contract of suretyship. That appears to me correct.

42. In contracts of suretyship, the principle, known as the rule in *Holme v. Brunskill*, derives from the principles stated by Cotton L.J. in *Holme v. Brunskill* [1878] 3 QBD 495, and applied in this jurisdiction in *MacEnroe v. AIB* [1980] ILRM 171, at p. 175, namely:

> "The true rule, in my opinion, is, that if there is any agreement between the principals with reference to the contract guaranteed, the surety ought to be consulted, and if he has not consented to the alteration, although in cases where it is without inquiry evident that the alteration is unsubstantial, or that it cannot be otherwise than beneficial to the surety, the surety may not be discharged; yet, that if it is not self-evident that the alteration is unsubstantial, or one which cannot be prejudicial to the surety, the Court will not, in an action against the surety, go into an inquiry in to the effect of the alteration . . ."

43. Counsel for Friends First submits that prejudice to the surety is the cornerstone of the test for materiality. This also appears to me correct. Kenny J. in *MacEnroe v. AIB* [1980] I.L.R.M 171, at p. 182, explained the principles in the following terms:

> "The Bank accepts the principles stated by the majority in Holme v. Brunskill [1878] 3 QBD 495, and expressly approved by the Privy Council in Egbert v. National Crown Bank [1918] AC 903, that when a guarantor guarantees a transaction between two other persons, neither of them may make any alteration in the terms of the contract guaranteed unfavourable to the interest of the guarantor without his consent and that, if they do this, he is discharged."

44. In the High Court of Australia in *Ankar Propriety Ltd. v. National Westminster Finance* (Australia) Ltd. (1987) 162 CLR 549, Gleeson C.J. referred, at p. 557, to the "special principle" applicable to contracts of suretyship and the necessity to take into account "the special character of a suretyship contract". He also referred to the fact that the special principle has been expressed in a variety of ways, and having referred to a number of the decisions, including *Holme v. Brunskill*, stated at p. 559:

> "The consequence is that, to hold the surety to its bargain, the creditor must show that the nature of the alteration can be beneficial to the surety only, or that by its nature it cannot in any circumstances increase the surety's risk, e.g. a reduction in the debtor's debt or in the interest payable by the surety. The mere possibility of detriment is enough to bring about the discharge of the surety."

45. Taking into account the above approach to the determination of materiality in the context of a material variation, and construing clause 10.2(f) of the Facility Letter in accordance with the principles set out in *Analog Devices*, I have concluded that the term "material variation" therein means a variation which, objectively viewed, may prejudice the position of ACC in respect of its rights and entitlement pursuant to the Facility Letter and the security taken pursuant thereto. My reasons for doing so are as follows.

46. The focus of clause 10.2 of the Facility Letter is the preservation of ACC's full right and entitlement to secure the obligations undertaken to it in the Facility Letter by the borrowers and to the security taken over the property and its ability to obtain, if necessary, repayment of the Facility from the realisation of the secured properties. This is emphasised, firstly, by clause 10.2(a)

which governs the construction of the paragraph (i.e. 10.2) and provides:

> "(a) the paragraph shall be construed so as to maintain and preserve the obligations secured by the Facility and the Bank's Security to the extent of the benefits, rights and proceeds arising under or in connection with this Facility and the Bank's Security and so as to maintain the security conferred thereby."

Further, the provisions at paragraphs (b), (c), (d), (e), (h), (i), (j) of clause 10.2 are all focused on preventing any prejudice to ACC's security or its ability to receive the full proceeds of the realisation of the security. Also, whilst the pre-condition at clause 9(d) refers to all "co-ownership and partnership agreements", clause 10.2(f) only refers to the "co-ownership agreement" again a focus on the property.

47. The variation made by the supplemental agreement to clause 2 of the co-ownership agreement cannot objectively be construed as creating any prejudice to or adversely affecting in any way ACC's right and entitlement to obtain from Friends First, Mr. Lyne and Mr. Connellan performance of their obligations to it pursuant to the Facility Letter, or in any way prejudicing ACC's full right and entitlement to its security pursuant to the Facility Letter or to receive the proceeds of sale of any realised secured properties. As already pointed out, the supplemental agreement did not vary in any way the co-owners' respective interests in the properties, nor did it alter in any way their obligations to ACC pursuant to the Facility Letter. As already pointed out, at the time the parties entered into the co-ownership agreements (furnished to ACC's solicitor as a pre-condition to draw down), their obligations between themselves in accordance with clause 2 of the co-ownership agreements were different to the obligations which each had to ACC pursuant to the Facility Letter, including taking into account the limited recourse agreed at clause 10.1.

48. Accordingly, I have concluded that the supplemental agreement did not constitute a material variation of the co-ownership agreement within the meaning of clause 10.2(f) of the Facility Letter.

49. The next contention of ACC is that there was a material variation of the co-ownership agreement by the action of Friends First in making the payment to ACC on 12th October, 2009, in the amount of €138,404.47 i.e. at a rate of 36.988% of the total interest and not in the sum of €174,371.47, being 46.6% of the interest set out in the letter of 24th September, 2009. Friends First object that this claim was never pleaded. This objection is correct. It was not a matter pleaded. Nevertheless, I propose dealing with it as the relevant facts are before the Court and Friends First are not prejudiced by my now dealing with it. Mr. Browne, in evidence, made clear that he asked Crystal Partners to give him certain interest figures with a view to making payments to ACC. This included the amount for interest at 36.988%. As I have already held, this was an amount paid by Friends First on account of interest claimed by ACC and intended to facilitate negotiations with ACC. The making of the payment did not, in my judgment, effect any variation in the co-ownership agreement. It may have been inconsistent with the percentages agreed in clause 2 of the co-ownership agreement, but it did not have the effect of changing any agreement between the co-owners. It was, in fact, made in accordance with an agreement already reached between the co-owners i.e. the supplemental agreement, which, as I have determined, did not constitute a material variation within the meaning of 10.2(f) of the Facility Letter.

50. The payment made was approximately €36,000 less than the amount demanded by ACC in its letter of 24th September, 2009, which, in the context of the figures at issue in relation to the Facility and the total figures paid by Friends First for interest in October, 2009 was unsubstantial. This is supported by the evidence that ACC took no objection with the payment made, and as is later set out in this judgment, its internal loan strategy report of November, 2009 records Friends First as having met their obligation in the sum of (€898,000) for interest due on the several Crystal Fund facilities up to 24th September, 2009. Accordingly, the making of this payment did not, in my judgment, constitute a material variation of the co-ownership agreement by action within the meaning of clause 10.2(f) of the Facility Letter.

51. Finally, on this issue, ACC contends that Friends First was guilty of wilful misconduct within the meaning of clause 10.2(j)(v) of the Facility Letter in failing to pay the interest due by it in May, 2009 and in making the reduced payment in October, 2009.

52. In this connection, Friends First submits, in reliance upon a similar view taken by McGovern J. *in Danske Bank A/S Trading As National Irish Bank v. Durkan New Homes and Others* [2011] IEHC 325, that as under the Facility Letter, the intent of the parties is that there should be limited recourse to the borrowers unless one of the events set out in clause 10.2 occurred, and having regard to the serious consequences of the lifting of the entitlement to rely on limited recourse, the provisions of clause 10.2 should be strictly construed. I accept that the lifting of the entitlement to limited recourse is a very serious matter for Friends First and the other borrowers. It does not appear to me helpful to refer to "a strict construction" of the Facility Letter. It should be construed in accordance with its terms and the principles already set out. However, the onus is on ACC to establish that the circumstances giving rise to a loss of limited recourse has occurred in accordance with the normal evidential rules and onus of proof in civil proceedings.

53. In clause 10.2(j)(5), the failure to pay interest must amount "wilful misconduct" as that term is used. It is as appears used in conjunction with fraudulent misconduct and where a person is grossly negligent. Daniel Greenberg (ed.), Jowitt's Dictionary of English Law. 3rd Ed., (London, 2010) at p. 2424, defines wilful misconduct as "conduct that transgresses a line drawn by public policy involving the deliberate or reckless incurring of a risk. The mental element of the concept is subjective; objective negligence, no matter how reprehensible, does not suffice". In the same text at p. 2424, "wilful" is defined as "intentional or deliberate".

54. In my judgment, the failure of Friends First to make any interest payment in response to the letter of 6th May, 2009, and the underpayment made on 12th October, 2009, does not amount to wilful conduct in the sense explained. The letter of 6th May, 2009, as already stated, was a standard letter and as Mr. Crowe confirmed in evidence, was not issued pursuant to any decision to call in the Loan. The letter does not identify the amount of interest then alleged to be due and owing by Friends First or the other borrowers. There was no express demand to Friends First to make an interest payment of 46.6% of the accrued interest. The only demand related to the total amount for principal and rolled up interest. There was no indication that ACC considered Friends First no longer entitled to the benefit of limited recourse in accordance with clause 10.1(a) of the Facility Letter. There is no evidence before the court of any intentional or deliberate misconduct by Friends First in not making an interest payment in response to the letter of 6th May, 2009.

55. The circumstances in which the lesser payment was made on 12th October, 2009, are already set out. Again, there is no evidence of international or deliberate misconduct in making the payment at the lesser percentage. It was a payment made in accordance with the agreement between the co-owners in respect of interest to facilitate negotiations. In my judgment, it could not amount to wilful misconduct on the part of Friends First as that term is used in clause 10.2(j)(5).

56. Hence, I have concluded that the provisions of clause 10.1(a) did not cease to apply to Friends First.

Waiver Estoppel Election

57. By reason of the conclusions reached above, it is unnecessary to consider these issues and I do not propose lengthening this judgment by so doing. The facts relied upon by counsel for both parties in legal argument are already determined in the judgment.

Interest during the Term of the Facility
58. There are a number of issues in contention between the parties in relation to the interest, if any, now due and payable by Friends First to ACC. There is a regrettable lack of clarity in the relevant provisions of the Facility Letter. The first issue is whether or not Friends First is liable pursuant to clause 10.1(a)(ii) for the payment of 46.6% of the interest which accrued from time to time under the Facility during its 18-month term and which, pursuant to clause 6, was rolled up and capitalised. ACC contends that it is so liable and Friends First that it is not.

59. In my judgment, construing clause 10.1(a)(ii) in accordance with the ordinary meaning of the words used in the context of the remainder of clause 10.1, and the remaining provisions of the Facility Letter in accordance with the principles set out in *Analog Devices B.V. v. Zurich Insurance Company* [2005] IESC 12, [2005] 1 I.R. 274, Friends First is now liable for such interest. Firstly, this is in accordance with the words used in clause 10.1(a)(ii) limiting the liability of Friends First "as to the payment of all interest accruing from time to time under the Facility to 46.6% of all such interest". The interest which accrued during the term of the Facility undoubtedly comes within the description of "interest accruing from time to time under the Facility". Counsel for Friends First sought to rely, in particular, upon the provisions of clause 6 to the effect that interest was to be rolled up and capitalised until it reached €3.2m and then (and as he submits, only then) that the borrower should pay all interest charged to the facility in excess of that amount within 14 days of it being charged. In my view, clause 6 relates to the time at which interest falls due to be paid as distinct from the liability of Friends First for the payment of interest. The obligation in clause 10.1(a)(ii) to pay all interest accruing must be read in the context of the entire of clause 10.1(a). As already set out above, in this clause, the bank agrees to limit recourse to and the liability of Friends First:

> "(i) as to the repayment of the principal of the Facility to the sum realised from the sale of the Bank's Security; and
>
> (ii) as to the payment of all interest accruing from time to time under the Facility to 46.6% of all such interest."

The term "the principal of the Facility" is not defined. Counsel for Friends First pointed out that the facility, in accordance with paragraph 2 of the Facility Letter, is stated to be an amount of up to €25,250,000.00. He sought to argue that the term "the principal of the Facility" should accordingly be given a different meaning i.e. one which included the interest which was to be rolled up and capitalised during the term of the facility. He also made reference to clause 2.2 in the General Conditions which provides:

> "**2.2 Interest**
>
> 2.2.1 Interest will be payable by the Borrower on all principal amounts outstanding under each Facility at the rate and at the times specified in the Sanction Letter.
>
> 2.2.2 Accrued interest will be capitalised and thereby added to the principal on such dates as the Bank may, from time to time, fix and thereafter interest shall be payable on such capitalised sum."

60. Whilst I accept that the term "principal amounts" when used in General Condition 2.2.1 includes capitalised interest, it does not appear to me that in clause 10.1(a) of the Facility Letter that it is being used in the same context. In that clause, the parties are agreeing that recourse to or the personal liability of Friends First will be limited in a particular manner. The parties are agreeing to do so in respect of two separate potential sums under the Facility. In the sense used in paragraph 10.1(a) of the Facility Letter, it appears to me that the sums referred to in paragraph (i) i.e. "the principal of the Facility" and that in paragraph (ii), "all interest accruing from time to time under the Facility" are intended to be exclusionary one of the other. Accordingly, for the purposes of this paragraph, it appears to me that the term "principal of the Facility" is intended to refer only to the original amount advanced and that all interest accruing from time to time under the Facility, albeit that it may have been rolled up or capitalised, is subject to clause 10.1(a)(ii) such that Friends First is liable for 46.6% of such interest.

61. I am conscious in reaching this conclusion that it may be considered to be at variance with the letter dated 6th May, 2009, addressed to all three borrowers informing them that the total amount due on 21st May, 2009, was €27,694,323.45 (i.e. the total amount including capitalised interest) and asking that they arrange for payment of the amount on or before that date. It does not appear to me that anything turns on this letter. It is what appears to be a standard letter coming up to the expiry of a facility addressed to all three borrowers. It takes no account of the special limited recourse provisions in the Facility Letter or the personal liability of the individual borrowers.

Interest after 21st May, 2009
62. This issue gives rise to a most difficult question of construction of the Facility Letter. ACC contends that the proper meaning of paragraph 10.1(a)(ii) is that Friends First remains liable to pay it 46.6% of all interest accruing from time to time on all amounts outstanding under the Facility until it has been fully repaid. It contends that such obligation continues, even after the secured properties have been sold and Friends First's liability for principal is extinguished pursuant to clause 10.1(a)(i).

63. Friends First's contention commences at the other end of the scale. It submits, firstly, that it has no liability for interest after the expiry of the term of the facility i.e. 21st May, 2009.

64. The Facility Letter does not explicitly address the continuing liability of Friends First for interest or the date upon which it ceases, having regard to the limitation on recourse for principal to the amount realised from the secured properties. I cannot accept either of the extreme propositions of the parties as to the construction to be given to the Facility Letter in accordance with the principles set out above.

65. I reject the contention of ACC that the meaning conveyed by the Facility Letter to a reasonable person with the relevant background knowledge is a continuing liability in perpetuity for interest where the liability for principal is limited to the sale proceeds. It makes no commercial or common sense to construe the Facility Letter as limiting the recourse to Friends First for principal, whilst at the same time as imposing on it a continuing liability for interest. If such were the construction, then the only way in which Friends First could bring to an end its liability for interest would be by repayment of the principal (assuming that there is a balance outstanding following realisation of the secured properties and any realisations pursuant to the judgments obtained against the co-owners). In my judgment, it would be inconsistent with the explicit agreement to limit recourse for principal to the amount realised from the secured properties to construe the document as imposing a continuing liability for interest after the properties have been realised, and hence should not be so construed.

66. On the other hand, I do not accept the construction contended for by Friends First that there is no continuing obligation to pay interest after the expiry of the 18-month term of the facility. Such a construction is not implicit in clause 10.1(a). The words "all interest accruing from time to time under the Facility", when considered in the context of the remainder of the Facility Letter and the General Conditions, cannot be so understood. Whilst ACC has agreed to limit its recourse for principal, the Facility Letter does not envisage immediate realisation on expiry of the Term nor would it be reasonable to imply such a term, having regard to the background of the business model of the development and sale of brownfield sites already set out. Rather, the Facility Letter, construed in its factual matrix, and having regard to clause 6, conveys that its term may be extended. In accordance with General Condition 2.2.1, interest remains payable by the Borrower (which includes Friends First) on all principal amounts outstanding under the facility. The liability of Friends First is limited to 46.6% of such interest, but there is no explicit limitation on the period during which this obligation survives, save, as I have already indicated, it appears to me that it would be inconsistent with the limited recourse for principal to construe the Facility Letter as imposing the obligation beyond the date of realisation of the secured properties.

67. Friends First submitted, in the alternative, that if there was a continuing obligation on it to pay interest, that such continuing obligation should only be for a limited period of time, during which it would be reasonable to expect ACC to realise the secured properties. They make this submission in reliance on the principles applicable to the duty on a lender to mitigate its loss by realisation of securities.

68. The Court was referred to Tomlinson & Grant Lender Claims, 1st ed., (London, 2010), para.s 5-23, where it is stated:

> "A lender is, like any other claimant, under a duty to take reasonable steps to mitigate his loss. The burden of pleading and proving a failure to mitigate is on the defendant. Four contentions are commonly made: that the claimant unreasonably delayed in realising the security; that the claimant has unreasonably failed to litigate against third parties; that reasonable care was not taken to sell the security for proper price; and that the claimant has failed to enforce the Borrower's covenant to repay."

69. In their treatment of the first contention, which is of some assistance, the authors point out the question of whether a lender has failed to mitigate his loss by not realising the security earlier will depend upon the facts of each case. The facts of this case differ considerably from the norm insofar as, unusually, the amount realised for the security has no impact on the amount of the liability of Friends First for principal. Rather, it is the time at which realisation takes place which, upon my construction of the Facility Letter, affects the continuing liability of Friends First for interest.

70. In these proceedings, Friends First has pleaded at paragraph 14 of the amended defence:

> "Following the expiry of the term, it was at all times open to [ACC] to take possession of the Lands and apply the proceeds of realisation of the Lands in discharge of the facility. [ACC] at all times owed [Friends First] an obligation to realise the security promptly and thereby satisfy any liability [Friends First] had in respect of principal."

71. Whilst the term of the facility expired in May, 2009 on the evidence, I find it was reasonable for ACC not to have taken any step to realise the security until the end of November, 2009. My reason for this is that it is undisputed that negotiations proceeded throughout this period in relation to an extension or reorganisation of the facilities relating to several of the properties in the Crystal Fund in respect of which ACC had made loans.

72. However, on 24th November, 2009, Mr. Crowe, on behalf of ACC, wrote to Mr. Browne on behalf of Friends First with whom he had been conducting the negotiations setting out ACC's understanding of certain proposals in relation to the extension and reorganisation of a number of the facilities relating to the properties in Crystal Fund 1 and in Crystal Fund 2. In that letter, Mr. Crowe informed Mr. Browne that ACC's credit committee was not prepared to accept the proposed restructure and then continued to state:

> "We wish to advise that in the absence of a significantly revised proposal, the Bank will immediately seek to protect its position . . ."

He also made clear:

> "ACC Bank will continue to demand interest in respect of all facilities according to the recourse set out in each individual loan. Interest continues to accrue at surcharge level. We will correspond on each individual loan in the coming days."

Finally, he stated:

> "Should [Friends First] fail to provide more meaningful support, in particular vis a vis the ongoing servicing of interest, combined with an additional and substantial equity injection or provision of a shortfall guarantee, then ACC Bank will not extend its loans and move to protect our position."

73. The undisputed evidence is that within approximately one week, Mr. Browne informed Mr. Crowe that Friends First was not going to make any further proposal. It is also agreed that Mr. Browne made clear that Friends First did not consider that it had any ongoing liability for interest on the Facility. I am satisfied that that position was known more generally within ACC by the beginning of December, 2009. There was produced in evidence an internal loan strategy report as at 30th November, 2009, in relation to the Crystal Partners/Friends First connection. This document was a document significantly redacted and related to all the facilities, only one of which is the subject matter of these proceedings. The executive summary summarises as amongst the changes since the last report:

> "• On 24/09/09 ACC issued an interest demand totalling EUR 1.7 M. to all parties. This covered interest due up to that date. [Friends First] met their obligation (EUR 898 K) on 12/10/09. The other parties have failed to meet their respective obligations claiming an inability to pay.
>
> . . .
>
> [Redacted]
>
> • [Friends First] have advised they believe [ACC] does not have recourse to them for interest indefinitely post-expiry of facilities and have now indicated they will not continue to fund interest."

The same document records that Crystal Partners had provided business workout plans for the subject sites and that ACC had appointed HOK, Savilles/O'Connor Murphy Gubbins (OCMG) Limerick to undertake a marketability report in respect of each of the ACC Crystal Fund sites. In respect of the Gaurus lands, it is noted at p. 25 of the Report that there is no recourse to [Friends First] for principal amount. Further, it records a DNG valuation at December, 2008 of €33,950,000.00 and a HOK/OCMG at November, 2009 of €9,700,000.00. That internal report was not available at the time to Friends First. However, the evidence of Mr. Browne is that they were aware of those valuations in November, 2009.

74. No evidence was adduced by ACC of any steps taken by it in relation to the Gaurus lands or loans prior to the letter from McCann Fitzgerald of 1st April, 2010, demanding payment of the full amount of the Facility and interest thereon and contending that limited recourse had been lost pursuant to paragraph 10.2 of the Facility Letter. No evidence was given of any steps subsequently taken to realise the Gaurus lands nor of any difficulties in relation to its entitlement to take possession. Equally, Friends First has not adduced any evidence of any requests made by it to ACC to realise the Gaurus lands. This inaction by both parties may in part be explained by the dispute in these proceedings in relation to the continued application of the limited recourse provision in clause 10.1 and more significantly, by the present property market.

75. The general duty of ACC to take steps to mitigate its loss is of assistance in determining a reasonable implied term as to the period for which Friends First remains liable for 46.6% of the interest accruing under the Facility. Having regard to the construction which I have placed on the Facility Letter, namely, the continued application of clause 10.1(a), and a continuing liability of Friends First to pay 46.6% of interest to a date which is no later than the realisation of proceeds of sale from the Gaurus lands, it does appear that the Facility Letter should also be construed as including an implied term consistent with the duty to mitigate its loss that ACC will realise the lands within a reasonable period of time of calling in the Loan. The Facility Letter could not be construed as permitting ACC to take no steps to realise the properties and simply demand continuing interest on the outstanding facilities. If ACC failed to take such reasonable steps in breach of the implied terms, they would cease to be entitled to receive continuing interest. What is a reasonable time must also be construed in the context of the property being brownfield sites.

76. As with the duty to mitigate its loss, it appears to me that the onus is on Friends First to adduce evidence of and establish that ACC has acted in breach of its implied obligation to realise the properties within a reasonable period of time. In the absence of Friends First adducing any evidence of a demand made by it to ACC to take steps to realise the Gaurus lands, it appears that a reasonable period for the realisation of the Gaurus lands, having regard to the business model for which the Facility was granted, is two years from the date of formal demand for repayment i.e. 1st April, 2010. In the absence of a completed sale by that date, the Facility Letter should be construed as meaning Friends First's liability for interest ends at the expiry of that period. Hence, I conclude that Friends First is liable for 46.6% of the interest due on the Facility up to and including 1st April, 2012, that its liability for interest ceases on that date.

Surcharge or Penalty

77. ACC claims that it is entitled to charge additional interest at 6% per annum or 0.5% per month on the amount of the Facility, including capitalised interest outstanding on 21st May, 2009, and thereafter, pursuant to clause 2.7.1 of the General Conditions. This provides:

> "If the Borrower defaults in the payment on the due date of any sum (including but not limited to interest, costs, fees, charges or expenses) payable under a Facility, the Borrower shall pay on demand interest thereon from and including the date of such default to the date of actual payment calculated (as well as before judgment) at 0.5% per month above the rate otherwise applicable to the Facility."

78. It is not in dispute that there was a default in the repayment of the Facility pursuant to clause 6 of the Facility Letter when its term expired on 21st May, 2009. The issue is whether or not the additional rate of interest of 6% per annum or 0.5% per month referred to as the surcharge rate is or is not a penalty. Friends First contend that it is a penalty. ACC contends that it is a contractual term of an agreement entered into between two equal parties to which effect should be given.

79. It is commoncase that the well-known principles according to which the courts in this jurisdiction will consider whether a term in a contract which provides for the payment of a sum of money on a default or breach of the contract is or is not a penalty are those set out by Dunedin L.J. in Dunlop Pneumatic Tyre Company Ltd. v. New Garage and Motor Company Ltd. [1915] AC 79, at p. 86, see Pat O'Donnell & Co. Ltd. v. Truck & Machinery Sales Ltd. [1998] 4 I.R. 191, per Barron J. at p. 214. In summary, they require 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 principles apply more generally than to the imposition of default or surcharge interest.

80. Both parties referred to the consideration by Colman J. in the High Court of England and Wales in *Lordsvale Finance plc. v. Bank of Zambia* [1996] Q.B. 752, to the same principles in the context of a facility agreement between the defendant bank and a syndicate of banks under which one of the elements of interest payable following default was an additional 1%. The issue was whether or not such additional 1% was or was not a penalty. Colman J., having referred to the authorities preceding Dunlop Pneumatic Tyre Company Ltd. and that authority, concluded that if on default the additional interest was payable with retrospective effect, it would have all the indicia of a penalty. He then continued at p. 763:

> "Where, however, the loan agreement provides that the rate of interest will only increase prospectively from the time of default in payment, a rather different picture emerges. The additional amount payable is ex hypothesi directly proportional to the period of time during which the default in payment continues. Moreover, the borrower in default is not the same credit risk as the prospective borrower with whom the loan agreement was first negotiated. Merely for the pre-existing rate of interest to continue to accrue on the outstanding amount of the debt would not reflect the fact that the borrower no longer has a clean record. Given that money is more expensive for a less good credit risk than for a good credit risk, there would in principle seem to be no reason to deduce that a small rateable increase in interest charged prospectively upon default would have the dominant purpose of deterring default. That is not because there is in any real sense a genuine pre-estimate of loss, but because there is a good commercial reason for deducing that deterrence of breach is not the dominant contractual purpose of the term.
>
> It is perfectly true that for upwards of a century the courts have been at pains to define penalties by means of distinguishing them from liquidated damages clauses. The question that has always had to be addressed is therefore whether the alleged penalty clause can pass muster as a genuine pre-estimate of loss. That is because the payment of liquidated damages is the most prevalent purpose for which an additional payment on breach might be required under a contract. However, the jurisdiction in relation to penalty clauses is concerned not primarily with the enforcement of inoffensive liquidated damages clauses but rather with protection against the effect of penalty clauses. There would therefore seem to be no reason in principle why a contractual provision the effect of which

was to increase the consideration payable under an executory contract upon the happening of a default should be struck down as a penalty if the increase could in the circumstances be explained as commercially justifiable, provided always that its dominant purpose was not to deter the other party from breach."

He then continued to review a number of older decisions in England and Wales where the courts had upheld a prospective increase in the rate of interest and decisions of the Canadian courts to like effect. He also observed that it is settled law in the State of New York that default interest rates charged prospectively will not generally be struck down. Finally, Colman J. referred to Re David Securities Pty. Ltd. v. Commonwealth Bank of Australia (1990) 93 ALR 271, 300, and stated that the Federal Court of Australia concluded that if the interest rate increase was not retrospective operating in respect of the period before the default, it would be enforced "as a genuine pre-estimate of compensation to the bank with respect to funds it would otherwise have had available to it to reinvest". He then concluded at p. 766:

> "While fully accepting that the English authorities can hardly be described with justification as a 'long line of authority' (pace the Federal Court of Australia) and that none of those authorities is notable for its clarity of analysis, such authority as there is does suggest that at least on three occasions since 1725 the courts have been prepared to enforce increased rates of interest or analogous payments where the increase applied as from the date of default. On the other hand, the conventional line of authorities characterising default interest as a penalty appears to be based on cases where the default interest provision operated retrospectively as well as prospectively from the date of default.
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> . . .
>
> In my judgment, weak as the English authorities are, there is every reason in principle for adopting the course which they suggest and for confining protection of the creditor by means of designation of default interest provisions as penalties to retrospectively-operating provisions. If the increased rate of interest applies only from the date of default or thereafter there is no justification for striking down as a penalty a term providing for a modest increase in the rate. I say nothing about exceptionally large increases. In such cases it may be possible to deduce that the dominant function is in terrorem the borrower. But nobody could seriously suggest that a 1 per cent rate increase could be such. It is in my judgment consistent only with an increase in the consideration for the loan by reason of the increased credit risk represented by a borrower in default."

81. The judgment of Colman J. was considered by the Court of Appeal in *Murray v. Leisureplay plc*. [2005] EWCA Civ. 963. Arden L.J. and Clarke L.J. referred with approval to the approach of Colman J., the latter doing so as the "modern approach to Lord Dunedin's test in *Dunlop Pneumatic Tyre v. New Garage and Motor Company Ltd*., [1915] A.C. 67, and stated at para. 106:

> "It is perhaps no longer entirely appropriate to ask whether a payment on breach was stipulate in terrorem of the offending party but, as Colman J. put it in the Lordsvale case at p. 762G . . .
>
> 'whether a provision is to be treated as penalty is a matter of construction to be resolved by asking whether at the time the contract was entered into, the predominant contractual function of the provision was to deter a party from breaking the contract or to compensate the innocent party for breach. That the contractual function is deterrent rather than compensatory can be deduced by comparing the amount that would be payable on breach with the loss that might be sustained if a breach occurred'."

82. In this jurisdiction, the High Court is bound by the applicable principles in accordance with the Dunlop Pneumatic Tyre Company case as determined by the Supreme Court. However, I respectfully agree with Clarke L.J. in *Murray v. Leisureplay* [2005] EWCA Civ. 963, that the decision of Colman J. in *Lordsvale Finance v. Bank of Zambia*, [1996] Q.B. 752, may not be a departure from such principles, but rather, a modern application of them to the banking sector. Andrew Smith J. in the English High Court in *Donegal International Ltd. v. Republic of Zambia and Another* [2007] EWHC 197 (Comm.) at para. 509, referred to an analysis of the decision of Colman J. in *Lordsvale Finance plc*., by Jacob J. in the Court of Appeal in *Jeancharm v Barnet Football Club* [2003] EWCA Civ. 58, at para. 16, in the following terms:

> "That one can have an increased rate of interest as a valid clause in some circumstances appears from the decision of Colman J in Lonsdale(sic) Finance plc v Bank of Zambia, [1996] QB 752. In that case, there was an uplift of 1% for late payment of a debt. That was held to be a genuine pre-estimate on the basis that it indicated that the borrower was a risky borrower. There is nothing in the decision which suggests anything other than what Colman J. called a 'modest increase' would do."

83. There is one further applicable principle. It is that the courts are reluctant 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. In Canada, the Supreme Court has determined that it is unwilling do to so, absent oppression. However, in this jurisdiction, it appears to me that the position is similar to that in England as set out by Nelson J. in *Tullett Prebon Group Ltd. v. El-Hajjali* [2008] EWHC 1924 (Q.B.), at para. 31:

> "The notion that the Courts might be moving away from the position set out in Dunlop and adopting a broader discretionary approach was rejected in Jeancharm Limited, Keene L. J. at paragraph 21. The Supreme Court of Canada in Elsey v J G Collins Insurance Agencies Limited [1978] 83 DLR 15 had said:-
>
> 'It is now evident that the power to strike down a penalty clause is a blatant interference with the freedom of contract and is designed for the sole purpose of providing relief against oppression for the party having to pay the stipulated sum. It has no place where there is no such oppression'.
>
> Whilst the question of oppression cannot be regarded in English law as the sole test and the Dunlop approach is still extant (Phillips at 58 [Philips Hong Kong v. Attorney General of Hong Kong [1993] 61 BLR 49]) it is nevertheless a relevant factor to take into account as Lord Woolfe said in Phillips at 59:-
>
> 'Likewise, the fact that two parties who should be well capable of protecting their respective commercial interests agreed the allegedly penal provision suggests that the formula for calculating liquidated damages is unlikely to be oppressive'.
>
> The fact that the parties state that the clause is not a penalty clause and the fact that they are of equal

bargaining power are not decisive factors but they are certainly relevant to the consideration of the Court."

84. The onus of establishing that the imposition of a surcharge interest at 6% pursuant to clause 2.7.1 of the General Conditions is a penalty rests on Friends First. The parties to this agreement are both financial institutions capable of protecting their own commercial interests. The question to be determined, in accordance with the applicable principles in this jurisdiction i.e. Dunlop Pneumatic Tyre Company, is whether it represents a genuine pre-estimate of the bank's likely loss upon default at the time the Facility Letter was agreed i.e. November, 2007. Friends First contends that it cannot be so considered on the evidence adduced and that the only reasonable construction is that it was intended as a deterrent against default in the payment of interest or principal. The onus is on Friends First to so establish if it is to be considered a penalty.

85. Each of the parties called a banking expert, ACC, a Mr. Bowen, and Friends First, a Mr. Fennelly. Each are chartered accountants with significant banking experience and knowledge of the Basel Banking Accords. They were in agreement that Basel II was in operation in 2007. It was explained, *inter alia*, as being designed to ensure that a bank has adequate capital for the lending risk to which it is exposed. They agreed that a bank must attach a "probability of default" (PD) factor to each loan at the outset. Mr. Fennelly's evidence was that this would be one of the matters taken into account by a bank in determining the original lending rate, and in particular, where, as in this Facility Letter, the rate was made up of Euribor plus a margin (2%), it would be one of the factors which determined the applicable margin. The margin is also intended to create a profit element for the bank.

86. Both experts were in agreement that if a facility goes into default, then it must be re-categorised as impaired and that this has cost implications for a bank as it will need to set aside an increased level of capital for the anticipated loss. Mr. Bowen, in his oral evidence, stated that, generally, an impaired loan in banking means if the loan is in arrears in excess of 90 days.

87. Mr. Fennelly's evidence was that in 2007, 6% could not be considered a genuine pre-estimate of a likely loss or additional cost of funding to ACC if the facilities in relation to the Gaurus lands were at some stage to go into default. His evidence, which I accept, was that under Basel II, a generic pre-estimate of the additional cost of funding or loss to the bank would not be possible. Further, the Basel calculations are specific to each loan type and require to be determined having regard to the probable loss at the date of default. This would include consideration of such matters as the likely recoveries and security available to ACC and relevant recourse provisions. Mr. Bowen, in evidence, did not disagree that the cost of acquiring additional capital where a facility goes into default will vary, having regard to the nature of the default and, as he explained, differences in approach between banks to meeting the cost of capital and the requirement to aggregate across loans. He expressed the view that 6% is "a minimal reflection of the incremental cost of acquiring expensive capital, which all banks must procure in the marketplace where their balance sheets are damaged by an aggregation of 'Ennis-type defaulting loans'". Notwithstanding having expressed that view, he did not disagree that the actual cost would vary depending on the nature of the default.

88. ACC did not call any witness to explain the basis upon which 6% was included as the surcharge rate in its General Conditions and applied to the Facility the subject matter of these proceedings.

89. I have concluded, having regard to the evidence of Mr. Fennelly and Mr. Bowen, that the 6% surcharge interest cannot be considered as a reasonable pre-estimate in November, 2007 of the likely loss of ACC if the Facility was to go into default such as to trigger the applicability of the 6% *per* annum pursuant to clause 2.7.1 of the General Conditions. My reasons for doing so are as follows. The 6% rate is set in the General Conditions and, as a matter of contract, applies where there is default in the payment, not only of principal but also of any sum for interest, costs or charges. It applies from the date the default occurs. I accept the evidence of Mr. Fennelly that it is not possible to make a generic pre-estimate of the cost of default for the purposes of Basel II at the time the Loan was entered into. I accept, as a matter of probability, if a loan goes into default (certainly if it remains in default for a period of 90 days), there will be increased costs to the bank. However, on the evidence, it appears that those costs will depend upon the nature of the default. Whilst Mr. Bowen expressed an expert view that 6% is a minimal reflection of the incremental costs of the type of defaults in relation to this Facility, it is disputed by Mr. Fennelly and Mr. Bowen did not support it by evidence. I cannot accept this view, having regard to the variety of defaults which may trigger the application of the surcharge of 6% pursuant to clause 2.7.1 of the General Conditions.

90. I am further influenced by the size of the increase and relationship between the agreed interest rate of Euribor plus 2% which in November, 2007 on the evidence, was an aggregate of 6.68% and the proposed increase of 6%. It increases the agreed margin in the Facility Letter by a factor of three or almost doubles the applicable interest rate in November, 2007. In accordance with clause 2.7.1, if enforceable, this is permissible once even one interest payment is in arrears. It cannot come within the category of minimal increase accepted as being enforceable by Colman J in *Lordsvale Finance v. Bank of Zambia*, [1996] Q.B. 752. Further, even if it is permissible for the High Court in this jurisdiction to follow the approach of Colman J., there is not in this case evidence which permits me to conclude that an increase of 6% in the rate of interest agreed in 2007 for the variety of defaults envisaged in clause 2.7.1 of the General Conditions is commercially justifiable.

91. It follows from my conclusion that this cannot be considered as a genuine pre-estimate by ACC of its loss or the additional costs to it of providing capital in the event that there were to be a default. Hence, clause 2.7.1 of the General Conditions incorporated in the Facility Letter should be construed as a deterrent against default and a penalty. It follows that ACC is not entitled to recover surcharge interest herein.

Relief

92. ACC is not entitled to judgment in the amount claimed or the declaration sought. ACC is entitled to judgment for 46.6% of the interest accruing under the Facility up to 1st April, 2012, less €138,404.47 paid in October, 2009. I will hear the parties on the amount, if necessary, at a date to be fixed.