

## Consumer Credit Round-Up

### Speech by Ian Norman, Solicitor, Consumer Credit Specialist to the Institute of Credit Management: Secured Lending Group

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#### Introduction

2009/10 has seen an unprecedented amount of litigation in the consumer credit industry. The last 18 months has seen ever increasing growth of Consumer Action Forums on the Internet, fuelling the rise in demand for claims management and legal services from those seeking to write off their debts. Why? Perhaps some of it is trend? One attributing factor is surely the state of the economy? A depressed housing market and rising unemployment has undoubtedly contributed, giving rise to negative equity for those threatened with repossession. An upfront fee in exchange for the promise of a secured debt being written off must, to those affected, appear attractive.

This attraction has led to the proliferation of litigation in respect of all types of credit regulated by the Consumer Credit Act 1974, including, perhaps for the reasons I have suggested, secured loans and mortgages.

Today, my aim is to take you through some of the developments we have seen in case law over the last 12 months or so. There have been some monumental decisions at High Court and Court of Appeal level, which affect all those in the secured lending sector.

There are also more to come in the future, no doubt. For this reason, I will aim to take a look ahead to what 2010/2011 may have in store for those in the consumer credit industry too.

Let's take a look but before we do, in order to better understand why we are facing challenges to the enforceability of regulated agreements, it is perhaps worthwhile looking in brief at the law, which has caused so much strife...

#### The Prescribed Terms

The trouble begins with what are known as the "prescribed terms". These are set out in Schedule 6 of the Consumer Credit (Agreements) Regulations 1983. Depending on the type of credit agreement, these Regulations set out what information needs to be included in the agreement as a matter of paramount importance.

If any of these prescribed terms are missing or miss-stated; if the loan agreement was made before 6 April 2007 it is unenforceable. In fact, if the court holds that there is a breach of the prescribed terms, it is unable to make an enforcement order even if it considered it just to do so. So, if you seek to enforce a loan agreement and the borrower raises such a Defence, there is a risk that the court will declare it unenforceable. Worse, the court has power to decree that no future application for an enforcement order should be entertained. The agreement becomes what is known as "irredeemably unenforceable".

It is noteworthy that this provision of law was challenged under the Human Rights Act in the case of **Wilson -v- First Counties Trust**. The Government of the day fought and won the case in the House of Lords. However, it then appeared to concede that the provision was unjust and repealed it on 6 April 2007 **but not retrospectively**.

Therefore, the problem surrounding the "prescribed terms" relates specifically to regulated loan agreements made before 6 April 2007, of which there are many. Any loan agreement made after 6 April 2007, which contains an error in the prescribed terms is not irredeemably unenforceable but, instead, can only be enforced by an order of the court and the court has discretion to "reduce or discharge any sum payable by the debtor so as to compensate him for any prejudice caused". This is more favourable to Creditors as under the old law, the court was powerless to make any order enforcing the agreement.

Secured creditors may think that they are safe from this. After all, they have a charge, which they can rely on to ensure that when the property is sold, they will get their money. Unfortunately not, the provisions of the Consumer Credit Act state that creditors cannot avoid these formalities through their security, such as a mortgage over residential property. The security can be removed from the property.

So how have claims managers, solicitors and their clients sought to capitalise from the above and other provisions of the Consumer Credit Act 1974 and what has been the result?

#### ▪ **Southern Pacific Personal Loans Ltd –v- Walker [2009] EWCA Civ 1176**

Creditors often give Borrowers the option of adding fees, such as administration, legal and broker fees to the loan to be repaid over the term. In doing so, creditors charge contractual interest on them.

This is and was widely practiced throughout the industry – so why all the fuss? Well, borrowers have discovered section 9(4) of the Act, which states:

*“For the purposes of this Act, an item entering into the total charge for credit **shall not be treated as credit** even though time is allowed for its payment.”*

*(My emphasis)*

The aforementioned fees are charges for credit for the purposes of the Act and Regulations. Therefore, the above subsection requires that those fees should not be treated as credit, even if time is allowed for their repayment (i.e. they are repaid over the term). Therein lies the problem; borrowers argue that in charging interest on the fees, creditors have treated them as credit – therefore in contravention of section 9(4) of the Act.

#### ▪ **How Does this Render the Agreement Unenforceable?**

If the borrower’s case was correct, the amount of the repayments would be incorrect. This is because the repayments would include interest on fees, when by virtue of section 9(4), interest cannot be charged on them. The amount of credit would also be misstated, as it would not include the charges for credit added to the loan and repayable over the term. As the amount of credit and the amount of repayments are prescribed terms of the agreement, the loan agreement is irredeemably unenforceable if made before 6 April 2007.

The Question is – Does charging interest on fees mean that one has “treated them as credit?”

For now, the answer is no. Why?

#### ▪ **The Judgment**

This question was put to the Court of Appeal, which handed down its judgment on 12 November 2009. It decided the case unanimously in favour of the Creditor.

In support of the Court’s conclusions, Lord Justice Mummery referred to the fact that:

- Section 9 of the Act is there to define what is “credit” for the purposes of the Act. In fact, section 9(4) specifically states what credit does not include for the purposes of the Act.
- Interest is not a necessary indicator of credit.
- Interest free credit is, in fact, credit, for the purposes of the Act and therefore

It follows that, for the time being anyway, creditors are free to enforce agreements where they have charged interest on fees and charges added to loans to be repaid over the term. However, it should be noted that the *Walkers* were given leave to Appeal to the new Supreme Court and the case was heard on the 13 May 2010. The judgment of the Supreme Court is eagerly awaited...

▪ **Southern Pacific Mortgage Ltd –v- Heath [2009] EWCA Civ 1135**

This case involved “Multiple Agreements”. The Consumer Credit Act 1974 recognised that a credit agreement would not necessarily fall neatly into one classification of credit. It therefore introduced the concept of Multiple Agreements. Not only does this potentially affect regulated loans, it also has the potential to affect unregulated loans, as we shall see.

*Heath* argued that her mortgage was a multiple agreement in two constituent parts, which fell within section 18 of the Act. How?

Well, the loan itself was for a total of £28,932.50 and was therefore unregulated. However, as a condition of the loan, £19,000 of the advance was required to repay her existing mortgagee. The remaining £9,932.50 was available to use as she wished. *Heath* argued that this meant that £19,000 was what is known as “restricted-use credit” and £9,932.50 was a different category of credit, known as “unrestricted use credit.”

Why is this significant? Well, section 18 of the Act applies to an agreement, if its terms are such as:-

(a) to place part of it within one category of agreement so mentioned in this Act, and another part of it within a different category of agreement so mentioned, or within a category of agreement not so mentioned, or

(b) to place it, or a part of it, within two or more categories of agreement so mentioned.

(2) Where part of an agreement falls within subsection (1), that Part shall be treated for the purposes of this Act as a separate agreement.

(3) Where an agreement falls within subsection (1)(b), it shall be treated as an agreement in each of the categories in question, and this Act shall apply to it accordingly.

*Heath* argued that subsection (2) applied to her loan and that the two parts of the mortgage (the restricted use and unrestricted use credit) should be regarded as two separate agreements. As each individual sum was less than £25,000, each part was a regulated agreement. The mortgage was therefore improperly executed, because the prescribed terms for each part were not separately stated the agreement was unenforceable.

▪ **The High Court**

In the High Court his Honour Judge Purle QC noted that the Loan referred to the total mortgage advance and there was one loan; not two. It was a term of the loan that the existing mortgage should be paid off out of the total mortgage advance, but not any particular part of it. As the borrower did not have the option of

drawing down any particular part of the loan, it was difficult to see how the loan could be split into parts at all. He concluded that as there was only one advance, which fell into more than one category; subsection (3) applied. Sub-section 3 does not require the different categories of credit to be treated as separate agreements.

He held that even if the mortgage advance fell within more than one category of credit, it was not regulated by the Act as the single advance was for more than £25,000. For the apportionment to happen, the agreement needs to be in parts.

▪ **The Court of Appeal**

Following this decision, *Heath* appealed to the Court of Appeal. The judgment of the Court of Appeal was handed down on 5th November 2009. The Appeal was dismissed and Lord Justice Lloyd agreed with the judgment of the High Court.

Lord Justice Lloyd said that whether or not an agreement is in parts depends on the terms of the agreement, and not the categories of the credit in it. The loan agreement did not state how much was to be paid to the existing mortgagee, or how much was for *Heath*’s own use. There was only one advance, which could only be drawn down as a whole. Therefore, there was only one loan agreement for more than £25,000 and which was unregulated.

We understand that no appeal is being brought in respect of this decision, which is a very welcome outcome for Creditors.

## **McGuffick –v- Royal Bank of Scotland Plc [2009] EWHC 2386 (Comm)**

This case was an interesting one and was a direct consequence of the masses of requests being received by Creditors for true copy agreements and statements of account under s.77 of the Consumer Credit Act 1974.

As many of you are no doubt aware, the borrower is entitled for a fee of £1 to request a true copy of the executed agreement and a statement of account from the Creditor. In the event that the Creditor fails to comply with the request within a period of 12 working days, it is in breach of the Act and cannot enforce its agreement whilst the default continues. Before the 26 May 2006, if the default continued for a period of one month a criminal offence was committed. This is no longer the case, a fact which many claims managers and solicitors I come across do not appear to have grasped.

RBS, initially, could not find a copy of the loan agreement in order to fulfil the section 77 request but stated that Mr McGuffick should continue making payments. If he did not, RBS confirmed that they would register his default with Credit reference Agencies. Mr McGuffick issued proceedings for a declaration that his loan agreement was unenforceable and for an injunction to prevent his default being reported to credit reference agencies and the resulting harm to his credit rating.

The court was asked to determine the following points:

1. Whether Bank's right to be paid and the debtor's obligation to pay continues whilst the bank is unable to enforce the agreement under the Act?

Q1 Decided in favour of the Bank. The bank has a continuing right to be paid and the debtor has a continuing obligation to pay;

2. Whether reporting non-payment and other information to credit reference agencies is enforcement and so prohibited by the Act during the bank's period of non-compliance with s.77 of the Consumer Credit Act 1974?

Q2 Decided in favour of the Bank. Reporting borrowers to credit reference agencies is not enforcement for the purposes of the Act;

3. Whether the debtor had any right, which might be properly protected by an injunction requiring the bank to comply with section 77?

Q3 Decided in favour of the Bank in the circumstances of the case. Whether or not such an injunction should be granted was dependent upon the individual facts before the court. Non-compliance with

section 77 was not, of itself, enough to justify an injunction.

4. Whether reporting non-payment and other information to credit reference agencies contravened the Data Protection Act in the circumstances or may be restrained under the provision of section 10 of the same Act during the bank's period of non-compliance with s.77 of the Consumer Credit Act 1974?

Q4 Decided in favour of the Bank, reporting to credit reference agencies is fair, lawful and meets the conditions required by the Data Protection Act 1998; i.e. it was held that the use of Mr McGuffick's personal data was necessary for the legitimate interests of the bank or the credit reference agencies concerned.

On this point, I would like to centre in on a passage from the judgment itself, at paragraph 114. The bank's solicitors consulted the Information Commissioner's Office and in an e-mail of 14 July 2009, they said that it was appropriate for credit reference agencies to record information about unenforceable credit agreements because, amongst other reasons, such information may properly inform responsible lending decisions irrespective of whether the liability of the debtor is enforceable. The ICO said that responsible lending decisions are dependent upon creditors receiving information about the ability and/or inclination of individuals to repay their debts.

On the face of it, this is extremely useful. It means that the debt remains outstanding; it is just that the court can make an enforcement order. It will hopefully dissuade those seeking to avoid their debts on technicalities from actually doing so; as many dependent on credit will not, in all likelihood wish to see their credit ratings tarnished.

5. Whether reporting non-payment and other information to credit reference agencies and other debt collection activity during the bank's period of non-compliance with s.77, makes the relationship between the debtor and the creditor unfair under s.140A of the Consumer Credit Act 1974?

Q5 Decided in favour of the Bank. Reporting and other debt collection activity does not make the relationship between the creditor and debtor unfair by reason of the creditor's non-compliance with section 77 of the Consumer Credit Act.

Other issues were discussed during the trial of the matter and the following advice was given by the court but which is not binding on County Courts:

There is a continuing right to payment and a corresponding obligation to pay under an agreement, which is irredeemably unenforceable.

Instructing collection agents, serving default notices, asking for payment and issuing proceedings does not

constitute enforcement for the purposes of the Act. It is arguable that the Judge's decision that issuing proceedings was not enforcement was necessary to his other that reporting to CRAs is not enforcement. Accordingly that may well prove to be binding on County Courts.

This decision was a very useful one, from the point of view that it helped to counteract some of the spurious claims and applications to court for injunctions by borrowers who alleged that they were being harassed by collections teams seeking to recover arrears. It was however fairly narrow, in that it was decided in the context of whether or not it was lawful for a bank to report a customer to CRA's when unable to comply with its obligations under s.77 of the Consumer Credit Act 1974.

■ **Carey & Ors –v- HSBC Bank & Ors [2009] EWHC 3417 (QB)**

As we have seen in the case of *McGuffick*, the debtor can request a true copy of the credit agreement and a statement of account from the Creditor. *Carey* involved the equivalent provision of the Act relating to credit card agreements. S.78 but will no doubt equally apply to other loans (s.77). The case defined the meaning of "true copy".

The court held that:

- In order to satisfy a section 78 request, a creditor can supply a reconstituted copy of the agreement, produced from sources other than the original agreement.
- It need not supply a document, which would (if signed) comply with the Agreements Regulations at the date the agreement was made.
- The document must however contain the name and address of the debtor at the date the agreement was made, although this information can be obtained from records and need not be obtained from the original agreement. The name and address of the creditor should also be stated.
- If the agreement has been varied by the creditor under a unilateral power in the agreement (see s.82(1) of the Act), the creditor must provide the original agreement as well as the varied terms.
- A breach of s.78 (and therefore s.77) does not itself give rise to an unfair relationship under section 140A of the Act.
- The Court has power to make a declaration of non-compliance with s.78 (and s.77), although whether or not such a declaration is made will depend on the individual circumstances of any case. The Court will not make a declaration if the creditor admits in the proceedings that it has not complied with a section 78 (or 77), request.

- The prescribed terms are "contained" in the agreement if they are on a piece of paper stapled to the document signed by the debtor, where the document states that the "terms and conditions are attached".
- The fact that the Court has found, at trial, that there is no signed agreement containing the prescribed terms does not itself give rise to an unfair relationship under s.140A of the Act.

In his judgment, His Honour Judge Waksman also determined:

- That the purpose of a section 78 and therefore, by analogy, a section 77 request was informational and not to prove that a credit agreement was properly executed and enforceable. If an original credit agreement is lost or destroyed, a creditor can reconstitute a copy from its records, within these parameters.
- There is no need for the creditor to keep the original agreement; though they will have to keep sufficient information on record. Any reconstituted agreement should be "honest and accurate".
- If the creditor provides a reconstituted copy, it should as a matter of good practice tell the debtor that it is reconstituted.
- It is good practice to produce reconstituted agreements in a similar form to the original.
- Creditors enforcing agreements based on reconstituted information will have to prove that it is "honest and accurate".
- The fact that the creditor fails to comply with s.78 (or s.77) does not affect the underlying rights and liabilities of the parties. It is a matter for the debtor whether he wishes to take a risk and not make his payments. As per *McGuffick*, it was held that the obligations of the borrower and the rights of the creditor continue, the creditor can do all of the things we have seen in *McGuffick* to seek payment from the debtor; however the court will not be able to make an enforcement order.
- Borrowers will have to substantiate claims that their credit agreements are unenforceable and it will not be sufficient for them to claim that a document supplied in response to a section 77 or 78 request does not comply with the Act and Agreements Regulations.

This is another very welcome decision, which has undoubtedly helped to stem the tide of claims being brought against creditors under the provisions of the Consumer Credit Act. Additionally, it has given some very clear boundaries for Lenders and loan servicing teams to work within. Many claims were discontinued

against lenders in courts all over the country as a result of this and recently we have had the follow up case of *Teasdale v HSBC [2010] EWHC 612*, which confirmed that Lenders are not responsible for borrowers' costs on discontinuance even if they had a legitimate reason to bring the claim at the outset. The usual provisions regarding costs on discontinuance applies and the debtors were liable for the creditors' costs.

### ■ Regulation

The downturn has brought with it plenty of interventions and consultations by the regulators, such as the Office of Fair Trading (OFT) and the Ministry of Justice (MOJ). Save for some sort of miracle, there is no way I can cover everything, but here are some of the highlights.

### ■ Consumer Credit Directive:

It is perhaps inescapable that the Industry is undergoing yet further fundamental change; however, in light of my audience today I am going to give precious little exposure to the changes in Regulation brought about by the CCD. This is because it will not, when implemented (by the latest) on 1 February 2011 apply to Secured Lenders. It is however optional for those writing Secured Loans, with as I understand it, Secured Lenders being able to choose between the old or new regimes for new business. For more information on the Consumer Credit Directive, please see our website [www.lightfoots.co.uk](http://www.lightfoots.co.uk)

### ■ Ministry of Justice Consultation on Mortgage Repossession

This is particularly relevant for Secured Lenders. On 29 December 2009, the MOJ began consultation on closing the legal loophole, which potentially allows mortgage companies to repossess property without a court order where borrowers abandon their properties or surrender their keys to their mortgagee. If implemented, it will only affect owner-occupied homes and will not affect buy-to-let mortgages.

### ■ THE OFT – a year in 2 minutes...

It has been a busy year for the OFT, here is a quick look at the year gone by:

### ■ Consultation on unenforceable loan agreements:

Consultation recently ended on the provisions we have reviewed in both *Carey and McGuffick*. Consumers were very clearly being misled about what creditors are required to do to comply with requests for documents and the purpose of the provisions allowing debtors to request them. The Guidance supports the decisions in the cases we have seen on this issue and in addition, it states:

- A Creditor includes any assignee who acquires the debt – when purchasing regulated debt it is

therefore essential that one has access to the requisite information and records to be able to fulfil requests for information, including in respect of statements of account etc;

- The creditor should assure itself that the person making the request has the proper authority to do so. It should write to obtain such authority if in any doubt;
- Where a request is made by a single debtor in respect of a joint account, a response should be sent to both debtors;
- The duty does not apply if the agreement has been paid off or terminated, nor does it apply if judgment has been obtained, **unless** there is an interest after judgment clause that has not been expressly waived;
- If a claims management company does not hold a licence from the MOJ, the information should be sent to the debtor directly and the creditor should inform the debtor why. The creditor should notify the OFT and MOJ;
- Where a creditor cannot comply with the requirements of sections 77 or 78, it should not mislead the debtor by threatening court action when it knows it cannot enforce the agreement. It can however request payment and register default with CRAs.

### ■ Further revisions to OFT Information Sheets on Arrears and Default

On 22 March 2010 the Office of Fair Trading (OFT) issued General Notice 86 regarding changes to Information Sheets on arrears and default which must be given to borrowers with Notices under sections 86 and 87 of the Consumer Credit Act. These revised Information Sheets should be used **from 22 June 2010**. The Information sheets can be downloaded from the OFT website.

### ■ Irresponsible Lending Guidance

One of the changes brought about by the Consumer Credit Act 2006 was the introduction of Irresponsible Lending to the fitness to hold a consumer credit licence test. Many see the Guidance as a supplement to the provisions of the new Consumer Credit Directive. The OFT expects all consumer credit businesses to comply with both the word and spirit of the guidance.

The guidance extends to some 95 pages, but here is a very brief overview:

- Lenders will have to consider the suitability of a product to borrower needs and circumstances

- Assess debtor's ability to meet payments sustainably
- Monitor credit agreements and contact borrowers who show indications of being in difficulty
- Take responsibility for actions of third parties (such as brokers and debt collection agencies) on their behalf
- Explain the key aspects of credit agreements, highlighting warnings such as risks of not maintaining repayment
- Treat borrowers with consideration and forbearance, with action in respect of arrears always being fair and proportionate
- Not target 'vulnerable' potential borrowers – such as the over-indebted or those with a history of not managing credit well - for inappropriate credit products

▪ **A Look Ahead**

Well, it has been a whirlwind tour of Consumer Credit but I hope that you have found this round-up useful. So what might 2010/2011 bring?

One thing is for sure there are some further high profile cases to be decided no doubt. The Supreme Court decision in *Walker* is no doubt the next one. The good news is that so far at least the Courts appear to have taken a very pragmatic and common sense view on some of the novel arguments that have been raised so far. Another example is the case of ***Brooks v Northern Rock (Asset Management) Plc*** which deals with interest on regulated loans. Whilst I have not been able to cover this today, I will shortly be posting an update on this case to our website.

It is likely that claims against lenders will increasingly involve PPI over the next year and beyond. The majority of claims, which cross my desk at the moment, involve PPI and the way in which it was sold in the past. Many claims managers are likely to seek to exploit past market practices to allege that PPI included in regulated loans has rendered them unenforceable.

Creditors will no doubt be challenged under the new provisions in the Consumer Credit Act regarding Unfair Relationships, which we have touched upon in some of the cases reviewed and which give wide discretion to County Courts to rewrite the terms of loan agreements. Its application is likely to be a bit of a lottery and no doubt the higher courts will have to step in and give further guidance on its application.

One thing is for sure, lenders returning to the lending market will find a very different landscape to that they inhabited in the past. Lenders will undoubtedly be held more accountable for their actions and for the actions of those acting on their behalf in the future.

There is an increasing volume of guidance and with the tightening of regulation, such as we have seen in the OFT's proposals, lenders will have to ensure that they have the systems in place to ensure compliance.

Do keep updated on these and similar issues at our website, which is [www.lightfoots.co.uk](http://www.lightfoots.co.uk)

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This is a copy of Ian's speech to the Institute of Credit Management: Secured Lending Group business meeting held on 4 June 2010. It is intended as a general review of the law at the date of publication and is not to be regarded as legal advice. For specific advice on Consumer Credit Law, please contact Ian using the details, below.

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