

Consumer Credit Column September 2012



Richard Mawrey QC's Consumer Credit Column for the Practical Law Company September 2012

'A sense of false security'

As Benjamin Franklin remarked: 'In this world nothing can be said to be certain, except death and taxes'. The evident truth of this does not prevent us from perpetually seeking certainty, for with certainty comes security. Those in the moneylending business are always looking for security, if it can be had. The most secure debts are those backed by a charge over some tangible asset – real property or a saleable chattel – but security can also be found by having debts guaranteed by a third party. If a creditor takes a guarantee or indemnity from a surety and the principal debtor defaults, the creditor can enforce against the surety, thus giving him two possible sources of repayment. What, however, if the principal debt has been created by a consumer credit agreement regulated under the Consumer Credit Act 1974 ('CCA') and the agreement is, for some reason, permanently or temporarily unenforceable?



"A sense of false security."

It's odd, really, when so much litigation is geared to showing that an agreement is unenforceable, that so little thought has been put into what 'unenforceable' means. The distinction between a void contract and a contract which is unenforceable is easily stated in principle but often confused in practice. A void agreement presents relatively few conceptual difficulties. Whether the agreement simply never came into existence (as where the parties are not *ad idem*) or came into *de facto* existence but was void because of the operation of an external rule of law, the position is the same. No rights or obligations arise under the purported agreement.

Agreements which the law makes unenforceable by one of the parties, however, create a much more sophisticated and complicated juridical problem. Unlike a void agreement, an unenforceable agreement *does* create rights and obligations. Unenforceability relates to remedies and not to rights. Unenforceability removes remedies but does not extinguish the underlying rights and obligations. Those rights and obligations continue to exist: all that happens is that the law prevents a party from enforcing them in a particular way (normally by legal process).

The consequence of an unenforceable agreement creating rights and obligations is that, unless and until a time arises when enforcement becomes appropriate, the agreement functions as an entirely normal agreement. Enforcement only becomes appropriate when one party defaults on his obligations. Up to that point, everything done by both parties to the agreement is validly done. Neither party is a volunteer, gratuitously conferring a benefit on the other. This contrasts with a void agreement under which nothing is validly done. Money paid under an unenforceable agreement is validly paid in pursuance of a legal obligation: it is not money paid in respect of a non-existent or totally failed consideration nor is it money paid under a mistake of fact or law. Unlike the position with void agreements, such money is never recoverable by the paying party when the unenforceability of the credit agreement is discovered.

It is often overlooked that an 'unenforceable agreement' remains fully effective for both parties in all respects other than enforcement:

- the fact that payments made and received are lawfully made and received means that, in the case of a hire-purchase or conditional sale agreement, on the making of the final payment or on settlement by the hirer/buyer under CCA ss 94-5, title in the goods will pass to him;
- the agreement remains fully valid for other purposes (e.g. if it is a hire-purchase agreement relating to a motor vehicle, disposal of the vehicle will entitle the recipient to invoke Part III of the Hire-Purchase Act 1964 in order to obtain title);
- the agreement remains fully enforceable by the debtor or hirer even if he was a knowing and consenting party to the circumstances which rendered the agreement unenforceable; thus the hirer under an "unenforceable" hire-purchase agreement can sue the owner for damages for breach of the implied terms as to the fitness and condition of the goods;
- unenforceability relates only to breach and only to the future: thus a creditor or owner cannot recover arrears of instalments or recover damages following an otherwise lawful termination but no money already paid by the debtor or hirer to the creditor or

owner is repayable;

- the agreement always remains enforceable with the consent of the debtor – CCA s 173(3).

The limited consequences of an agreement being unenforceable impinge on securities and, in particular guarantees and indemnities. Rather weirdly, the CCA does not provide that all securities for a regulated agreement stand or fall with the agreement. It restricts the category of securities covered by the Act and legislates only for that category. Section 189(1) defines 'security' by saying "security" in relation to an actual or prospective consumer credit agreement or consumer hire agreement ... means a mortgage, charge, pledge, bond, debenture, indemnity, guarantee, bill, note or other right provided by the debtor or hirer, or at his request (express or implied), to secure the carrying out of the obligations of the debtor or hirer under the agreement' (emphasis supplied). Accordingly, when the CCA legislates for security it only legislates for security which is provided by the debtor or at his request. Security provided by the debtor means, in effect, real security (mortgage, pledge, bill of sale etc). Third party security such as a guarantee must be provided at the debtor's request: otherwise it is outside the regulation of the Act – see *Governor and Company of the Bank of Scotland v Euclidian (No 1) Limited* [2007] EWHC 1732.

If the security comes within the CCA, then there is an entire code dealing with it. Without going into detail, suffice it to say that, where the principal agreement is unenforceable or enforceable only with leave of the court, the security agreement is treated in a like manner – ss 106, 113 and 124. In practice this creates few problems.

The kite I would like to fly this month is to ask what the position would be if the guarantee of the regulated agreement were not a 'security' within s 189(1) and thus not covered by the provisions of the CCA at all. Can the guarantor still argue that, if the principal agreement is unenforceable, then his guarantee must also be unenforceable? There are obvious obstacles in the way of this argument. The CCA itself is an entirely self-contained code. This is made clear by s 170(1); 'a breach of any requirement made (otherwise than by any court) by or under this Act shall incur no civil or criminal sanction as being such a breach, except to the extent (if any) provided by or under this Act'. Thus, if the CCA makes a security unenforceable, all well and good, but if the security is outwith the Act, then breach of a provision of the Act in respect of the principal agreement cannot affect the enforceability of that security.

Does the general law applying to guarantees and indemnities help? Not entirely. There is a considerable body of authority to the effect that a guarantee or indemnity given in respect of an unenforceable (as opposed to void) agreement can itself be enforced. The courts have enforced guarantees or indemnities arising

- under an unenforceable contract by a minor prior to the Minor's Contracts Act 1987 – see *Wauthier v Wilson* (1912) 28 TLR 239 and *Yeoman Credit Limited v Latter* [1961] 1 WLR 828;
- under an ultra vires contract by a company to purchase its own shares – see *Garrard v James* [1925] Ch 616 and *TCB Limited v Gray* [1986] Ch 621, [1987] Ch 458;
- under a commercial contract where creditor and indemnitor arranged their commercial affairs on the premise that the indemnity would be honoured – see, for example, *Gulf Bank K.S.C. v Mitsubishi (Heavy Industries) Ltd (No. 2)* [1994] 2 LLR 145;
- under hire-purchase agreements rendered unenforceable under the Hire-Purchase Acts where the creditor and indemnitor have entered into a recourse agreement – again see *Euclidian* (above);
- under a land disposition contract unenforceable for failure to comply with the Statute of Frauds 1677 or the Law of Property Act 1925 see *Thomas v Brown* (1876) 1 QBD 714, *Monnickendam v Leanse* (1923) 39 TLR 445 and *Low v Fry* (1935) 152 LT 585;
- under a contract unenforceable against the principal debtor under the Limitation Act 1980 where the right against the surety is not itself statute-barred.

On the other hand there were decisions in the 1930s which struck down guarantees of debts covered by the Moneylenders Acts where the principal debt was unenforceable for want of the correct statutory form, though these decisions may be taken as turning on the actual wording of the Acts themselves – see *Eldridge and Morris v Taylor* [1931] 2 KB 416 and *Central Advance And Discount Corporation, Limited v Marshall* [1939] 2 K.B. 781.

Attempts in recent times to interest appellate courts in this problem have generally been unsuccessful – see *Conister Trust Limited v John Hardman & Co* [2008] EWCA 841 – but the question remains. If a regulated agreement is unenforceable by the creditor against the debtor by reason of some breach of the provisions of the CCA but a security given in respect of that agreement does not come within the definition in s 189(1) and is thus outside the Act, can the creditor none the less enforce the debt against the security? There is clearly a respectable body of argument for saying that he can.

Consumer Credit Law and Practice for thirty years and is co-author of *Blackstone's Guide to the Consumer Credit Act 2006* and *Butterworths Consumer and Commercial Law Handbook*.

clerks@hendersonchambers.co.uk

+44 (0)20 7583 9020