Can a borrower be a defaulter if a credit agreement is unenforceable?

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Dispute Resolution analysis: Can a lender properly register a default with a credit reference agency where a borrower has not made payment under a so-called 'irremediably unenforceable' credit agreement? William Hibbert, a barrister at Henderson Chambers, considers the Court of Appeal's decision in Grace and another v Black Horse Ltd.

Original news

Grace and another v Black Horse Limited [2014] EWCA Civ 1413, [2014] All ER (D) 05 (Nov)

The proceedings raised a question as to the legitimacy of registration as a default with credit reference agencies of a non-payment by a debtor (or hirer) of money contracted to be paid under a regulated, but irremediably unenforceable, credit agreement. The Court of Appeal, in allowing the claimants' appeal against the judge's finding that they had not established causation, held, among other things, that it had not been accurate to describe the first claimant as a defaulter under his hire purchase agreement once a competent court had decided that it had been irremediably unenforceable against him.

What is the significance of the Court of Appeal's decision?

This was a case about whether a lender can properly register with a credit reference agency a default where a borrower has not made payment under a so-called 'irremediably unenforceable' credit agreement. 'Irremediably unenforceable' credit agreements (a phrase coined by Lord Hoffman in *Dimond v Lovell* [2000] 2 All ER 897) are agreements where, because of particular failures to comply with the requirements for the proper execution of regulated credit agreements, the court is prohibited from making an enforcement order by the Consumer Credit Act 1974, s 127(3) and 127(4) (CCA 1974). Even though these subsections have been repealed in relation to agreements made on or after 6 April 2007, there are plenty of credit agreements still in place to which they apply and Mr Grace's hire-purchase agreement for a laptop computer was one such.

The case was a claim for damages brought by Mr Grace for breach of the Data Protection Act 1998, s 13 (DPA 1998) for contravention of the fourth DPA 1998 principle, which requires personal data to be accurate. The trial judge (HHJ Halbert, Chester County Court) found that the registration had been inaccurate in amount (£928 rather than the correct amount of £800) and in description (Mr Grace was described as a borrower rather a hirer under a hire-purchase contract) but that these inaccuracies had caused no loss as the differences were not significant as far as credit ratings were concerned. He also found that failure to review and remove or alter the registration was a breach of DPA 1998. However, HHJ Halbert considered that it was not inaccurate to register a default even though the agreement was (and indeed had been held by the court prior to registration) to be unenforceable. It was this decision on this last point that was overturned by the Court of Appeal.

In holding there was such a breach of DPA 1998 by registering a default where the agreement is wholly unenforceable, the Court of Appeal reached a decision that has far-reaching effects both for borrowers and

for the credit industry. The decision of course provides an important benefit for defaulting borrowers under unenforceable credit agreements, as an adverse entry with a credit reference agency can have a significant effect on the ability to borrow, or the cost of borrowing (the registration of Mr Grace's non-payment increased the cost of the annual percentage rate (APR) on a loan taken out by his co-habitee from 10.5%. to 17.9%). It also gives creditors a problem as, when deciding whether to lend, the fact of non-payment by the potential borrower is still relevant even if the agreement is unenforceable, but the credit reference agencies' systems do not currently allow the lender to make an entry explaining that, while there has been non-payment, this was under an unenforceable agreement--the judgment prevents them therefore registering such a default at all. Credit reference agencies will be under pressure to amend their systems to address the problem.

Finally, and importantly for the analysis of the contractual effect of an unenforceable contract, Briggs LJ, with whom Beatson LJ and Dyson MR agreed, considered of the nature of the borrower's liability under an unenforceable credit agreement, previously the subject of a first instance decision by Flaux J in *McGuffick v Royal Bank of Scotland* [2009] EWHC 2386 (Comm), [2010] 1 All ER 634 and confirmed the reasoning in that decision.

What approach did the court take to the arguments about limitation?

The offending entry had been filed by the lender at some date in 2003 before September or October, which was when Mr Grace found out about the default registration, and the claim was issued on 14 December 2009. This was outside the limitation period of six years in the Limitation Act 1980, s 9 (LA 1980). It was common ground that only damages after 14 December 2003 were outside the LA 1980, s 9 limitation period, but Mr Grace argued that the running of the period should be postponed under LA 1980, s 32 on the ground that registering a default was a deliberate breach of duty which was unlikely to be discovered for some time and therefore amounted to a deliberate concealment of facts (see LA 1980, s 32(2)).

Briggs LJ held that there had been no evidence of deliberate breach of duty:

'Deliberate commission of a breach of duty does not merely mean that the defendant is aware of what he is doing when committing the breach. It requires that he be shown to have been aware at the time that what he was doing was a breach of duty.'

In any event on the facts, Mr Grace had discovered the breach more than six years before the proceedings had commenced.

Briggs LJ noted that the point had not been taken that the failure to remove an offending registration was itself a continuing breach. He described this as 'an interesting question', leaving open the possibility that it is a continuing breach.

Why did the Court of Appeal decide there was a breach by registering a default where the agreement was wholly unenforceable?

Mr Grace's argument was that it was inaccurate to 'stigmatise' a borrower who had declined to make payments under an irremediably unenforceable credit agreement as a defaulter at least without stating in the registered entry that the agreement was unenforceable. As Lord Hoffman had said in *Dimond v Lovell* (supra):

'Parliament intended that if a consumer credit agreement was improperly executed, then subject to the enforcement powers of the court, the debtor should not have to pay...'

Briggs LJ stated that he did not find the decision easy. However the four arguments put forward by the lender did not persuade him, namely:

- that the debt remained extant and was not extinguished even though it was unenforceable
- the credit reference agencies' systems did not allow for the lender to record that the agreement was unenforceable
- other lenders had a legitimate interest on the public policy ground of responsible lending in finding out that Mr Grace had not paid and he should not be immune from this on a technicality, and

- there should not be introduced by a side wind an added penalty to the statutory sanction of unenforceability

Briggs LJ agreed that the description was in substance inaccurate. Parliament had decided that there was a class of consumer who should not have to pay a debt of a particular kind and it was counter-intuitive to think that a person held to be within that class 'can accurately be stigmatised as a defaulter in a semi-public register without, at least, the unenforceable nature of the debt being recorded in the same entry'. He described it as a 'statutory liberty not to pay', which 'is so central to any continued non-payment that the registration of his non-payment as a default is generally inaccurate unless accompanied with a reference to that liberty'.

Was it correct that the entry could not have stated that the agreement was unenforceable?

By signing up for the services of the credit reference agencies, lenders are placed under a contractual obligation to register non-payments in accordance with the agencies' terms. Currently there is no provision in the credit reference agencies' systems for the lender to note that the agreement was unenforceable. Briggs LJ gave short shrift to this as a reason to find there was no breach of DPA 1998:

'If an accurate registration cannot be accommodated, then the answer is for the industry to change its registration systems, and in the meantime for inaccurate registrations not to be made.'

However the Court of Appeal's attention does not appear to have been drawn to CCA 1974, s 159 which allows the borrower (but not the lender) to add a narrative notice of correction of not more than 200 words to the entry which notice will be included in any information based on the entry which the agency furnishes. It would seem it had always been open to Mr Grace to state on the register that the agreement in respect of which he had not made payment was unenforceable under CCA 1974.

It is not clear however that the borrower's power to correct the lender's entry could satisfy the lenders duty to be accurate in the first place.

Where does this leave Flaux J's decision in McGuffick?

In *McGuffick*, the lender had failed to provide upon request information and documents relating to a regulated credit agreement contrary to CCA 1974, s 77, with the consequence that the agreement had become temporarily unenforceable, pending the provision of that material. The question arose whether reporting the arrears to a credit reference agency in the meantime was unlawful enforcement.

The conclusion reached by Flaux J about the legal effect of remediable unenforceability was that the underlying contract remained in force, the rights and obligations under it were neither extinguished nor suspended, but that the enforcement of those rights was itself suspended, for as long as the temporary unenforceability lasted. Briggs LJ agreed that this analysis was correct, and further held that it was equally applicable to irremediable unenforceability (para [33] of his judgment).

Does that mean that non-payments under agreements which are enforceable on the order of the court can still be registered as a default?

Flaux J's analysis of the concept of unenforceability did not address the question in Mr Grace's case. Flaux J had considered the first of the DPA 1998 principles, which requires data to be processed fairly and lawfully and in compliance with one of the conditions in Sch 2 (condition 6 in Sch 2 is complied with if the processing is necessary for the purposes of the legitimate interests of the processor or the third parties to whom the data is disclosed) and had held that there was not a breach of that principle. But he did not specifically consider the fourth principle, which would require the registration of a non-payment to be accurate.

Briggs LJ expressly warned that his conclusion in Mr Grace's case:

'[...] may require a re-examination of remediable unenforceability, because I am by no means sure that the same analysis may not equally apply. Why should the exempt debtor be labelled a defaulter during any limited period during which Parliament had decided he should not have to pay?'

It looks as if the decision in *McGuffick* on the first principle will be outflanked by a future decision based on the fourth.

Would it make a difference to a credit rating if the entry says the agreement was unenforceable?

The outcome of the appeal was that the question of damages for the breach of DPA 1998 found by the Court of Appeal was remitted to the Chester County Court. But it may be that no loss was caused by the failure to inform other lenders that the agreement which Mr Grace chose not to pay was one that was unenforceable under CCA 1974. Potential lenders are surely wary of lending to a borrower who, while entitled under CCA 1974 to choose not to pay, in fact decides not to repay what he or she has borrowed.

What are the immediate consequences of the decision?

The decision does appear to be limited to the situation where the court has decided, or the parties have recognised, that an agreement is unenforceable--it is then that Briggs LJ considers that it becomes counter-intuitive to describe the non-paying borrower as a defaulter (para [42] of his judgment). If that is correct that gives significant protection to the lender, including in relation to registering an agreement which is enforceable but only on an order of the court.

No doubt the credit reference agencies will in time make arrangements to allow creditors to record the fact that the agreement is unenforceable. In the meantime, if the agreement is held or agreed to be unenforceable, then, since there is no mechanism to record the fact of unenforceability it appears that the non-payment should not be registered as a default. Any creditor should discuss with any credit reference agency with which it has a contract how this impacts on its contractual obligations with that agency.

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