Sutherland Professional Funding Limited v Bakewells (a firm) & others[1]

By Jonathan Lewis

- **This case dealt with a number of interesting issues under the Consumer Credit Act 1974, including:**
  The court found that even though a loan agreement stated a fixed amount for interest under a loan repayable within a set period, and gave an APR, it should also have stated the rate of interest as a prescribed term, as the rate varied depending on the length of the actual borrowing.

- **It found that where solicitors facilitate a loan on behalf of their client, they are the "supplier" in a debtor-creditor-supplier agreement and the agreements were therefore cancellable agreements, requiring notices of cancellation rights in proper form.**

[1] 2013 EWHC 2685 (QB).

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INTRODUCTION

1. Bakewells, a solicitor's firm, had a large number of clients who required funding to pay for disbursements in various personal injury claims that they were pursuing. For that purpose, each client entered into a loan agreement regulated by the Consumer Credit Act 1974 (the "**CCA**") with the claimant, "**SPFL**". The loans were made pursuant to a facility agreement between SPFL and Bakewells, referred to as the "Minute of Agreement" ("**MoA**"). Additionally, there was an agreement or understanding between Bakewells and SPFL contained in their correspondence that if a loan was repaid within 90 days no interest would be payable. This term was not recorded in the loan agreements. At the end of term of the loan, SPFL would agree an extension (for a charge) with Bakewells, which extension was not reduced to writing signed by the client.

2. The litigation arose from the fact that 69 cases that Bakewells undertook were either settled by accepting offers that were too low to allow repayment of the loans or were dismissed or discontinued. The consequence was that the clients were unable to meet their obligations under the loans and they became repayable in full.

3. SPFL decided not to pursue the clients, but to pursue Bakewells (and partners of Bakewells) under clause 5.1 of the MoA, which obliged Bakewells to pay "…the amount of the Total Amount Payable under the Loan Agreement …" that remained outstanding in any circumstances where "… the Loan Agreement is unenforceable against the Borrower at the instance of …" SPFL.

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4. SPFL claimed repayment of the total of the principal, and contractual and default interest due in respect of each loan. Bakewells defended the claim on the basis that the loans were irredeemably unenforceable under the CCA and that clause 5.1 was unenforceable in the circumstances. Further, it argued that clause 5.1 should be given a narrower construction than claimed by SPFL.[2] His Honour Judge Pelling QC allowed the claim in part: SPFL was successful on clause 5.1 issues but Bakewells was entirely successful on the consumer credit issues.

THE CONSUMER CREDIT ISSUES

5. Bakewells argued that the loan agreements were irredeemably unenforceable by reason of their failure to comply with the CCA and the Consumer Credit (Agreements) Regulations 1983, S.I. 1983/1553 (the "**Agreements Regulations**") and the Consumer Credit (Cancellation Notices and Copies of Documents) Regulations 1983, S.I. 1983/1557 (the "**Cancellation Regulations**"). This was because the agreements failed to state the interest rate and failed to state accurately how to make repayments (both prescribed terms) and failed to provide the correct wording for the prescribed notices of cancellation rights.

6. The loans were "regulated agreements" and "restricted use credit agreements" within the meaning of the CCA. They were for a fixed sum of £2,000 and interest was expressed as a fixed sum (usually

[2] This and a few other fact dependant issues and are not considered in this alerter as they raise no general points of interest.

£489). Repayment was required 18 months after the date of the agreement or earlier if the underlying claim was settled or concluded earlier. No interest rate was specified but an APR was stated at 16.3%.

Failure to specify the interest rate

7. Section 61 CCA provides that a regulated agreement is not properly executed unless it contains the terms prescribed by the Agreement Regulations. For agreements for fixed sum credit where the rate or amount of interest is variable, the regulations require there to be a term stating the rate of interest on the credit to be provided. The Defendants contended that this provision applied because the loan agreement provided for a variation of the rate of any item included in the total charge for credit after the relevant date.[3] SPFL argued that as there was a fixed sum of interest, it could not be said to vary.

8. HHJ Pelling QC held that if the loan were repaid earlier, as the same amount of interest was to be paid for a shorter period, it was implicit that the client would be paying a higher rate of interest. A rate was necessarily implicit where a sum is payable by way of interest.

9. SPFL further argued that it was sufficient that the loan agreement stated the APR.[4] This argument was dismissed given that the regulations distinguished the rate of interest from the APR: the APR

[3] Paragraph 4 of Schedule 6 requires the interest rate to be stated where paragraph 9(a) to (c) of Schedule 1 to the Agreement Regulations applies.
[4] This is calculated by way of a formula which is prescribed by the Consumer Credit (Total Charge for Credit) Regulations 1980.

was informational only, it was based on a prescribed formula and assumptions and it could be difficult if not impossible to back calculate the rate of interest from an APR (see *Sternlight and others v Barclays Bank plc. and others* [2010] EWHC 1865 (QB)).

10. As an alternative, Bakewells also argued that it was an implied term of the loan agreements that interest would be pro-rated dependent on when the loan was repaid. HHJ Pelling QC readily accepted this point, relying upon *A-G for Belize v. Belize Telecom Limited* [2009] UKPC 10 [2009] 1 WLR 1988, and held that any other conclusion would be absurd ([19]): "since interest is the sum payable to a lender for loss of the use of his money, the absence of an implied term…would illogically and un-commercially reward more to the lender the earlier the debtor was required to repay the loan… whereas commercially and logically interest should increase the longer the loan is outstanding". Because the amount (rather than the rate) of interest payable would vary under such an implied term, the rate of interest was again required to be stated as a prescribed term.

11. It followed that as the loan agreements did not contain the prescribed terms (the rate of interest was omitted) they were irredeemably unenforceable by operation of sections 65(1) (an improperly-executed regulated agreement is enforceable against the debtor on an order of the court only) and 127(3) CCA.[5]

[5] The loan agreements were entered into prior to 6 April 2007, on which date sections 127(3) and 127(4) CCA ceased to have effect in relation to agreements entered into on or after that date.

Failure to state how to perform repayment

12. HHJ Pelling QC held that as the side agreement as to no payment of interest within 90 days was not recorded in the loan agreements, the loans were unenforceable. He found that it was no answer to say that this part of the agreement was between Bakewells and SPFL and therefore the omission didn't matter. This was because the loans were to the clients and it was the clients who potentially benefited from the provision ([23]). Further, it was immaterial that none of the loans had actually been repaid within 90 days as the loans were to be tested for compatibility with the Agreements Regulations at the latest on the date when the first statutory copy is sent to the debtor ([24]).

Incorrect Notice of Cancellation Rights

13. The question as to whether the loan agreements contained the correct statutory form concerning cancellation rights turned on whether the MoA was a "debtor-creditor" agreement (a "**DC**" agreement) or a "debtor-creditor-supplier" agreement (a "**DCS**"). Section 64 (1) CCA requires the correct form to be included with every copy of the loan agreement supplied to the debtor – which form is determined by the Cancellation Regulations. Failure to comply rendered the agreement irredeemably unenforceable and there was no way around this (*Bank of Scotland v. Euclidian (No. 1)* [2007] EWHC 1732 [2008] Lloyds Rep. IR 182).

14. On the facts, the loan agreements would only be cancellable if they were DCS agreements where the solicitor was the supplier, as the

only face to face oral negotiations with the debtor that had taken place had been with the solicitor's representative. SPFL had arrangements only with the solicitor and not the insurer or claims management companies or suppliers of expert evidence. The issue in dispute was as to who was the "supplier".

15. Section 12 CCA defines a DCS agreement as being, in the present context, a restricted use credit agreement which falls within s.11(1)(b) and is made by the creditor under pre-existing arrangements, or in contemplation of future arrangements between himself and the supplier.

16. SPFL argued that Bakewells was not the "supplier", because the loans were for the purpose identified in the definition of "borrower" in the MoA – that is for "… payment of legal fees and outlays in respect of the provision of professional services …" to the borrowing client ([28]). It claimed that this referred to the payment of disbursements such as expert's fees, court fees and ATE premiums and that the solicitor merely acted as a conduit for the distribution of such charges on behalf of the client. As the loans were not made under pre-existing arrangements with any of these entities, it followed that the loans were not DCS agreements, but DC agreements, and therefore not cancellable.

17. Bakewells argued that it (Bakewells) was the supplier because the purpose of the loan agreements was to fund disbursements that under its contract of retainer it had contracted to and was obliged to pay on

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behalf of their clients to third parties and in respect of which it was entitled to be reimbursed by the clients. The loan was to finance this transaction with the client's solicitor. In determining this issue, the Judge considered the meaning of "supplier" in s.189; that section simply refers back to the meaning given to "supplier" by s.11(1)(b).

18. The Judge decided that a "supplier" is merely another party to a transaction that is being financed by the loan agreement, other than the creditor, rather than a supplier in the sense of providing the ultimate service. He reasoned that Bakewells thus had to establish that the loans were intended to finance the transaction between it and the client borrower. This turned on questions of fact.

19. The Judge found that Bakewells was the supplier for two primary reasons. First, because under its retainer, it was Bakewells's primary obligation to pay disbursements (including the ATE premium) as between it and the relevant service provider, whether or not put in funds by the client. Hence, the contract being financed was at least in part the contract between Bakewells and the client ([31]). Second, the retainer between Bakewells and their client was one that required the client to make good disbursements paid by the firm. In deciding this issue, the Judge considered the terms of the retainer between Bakewells and the clients, the CFA between them, Cook on Costs as well as the Code of Conduct then applicable to solicitors ([32]-[34]).

20. The Judge held that disbursements were payments that *Bakewells* was obliged to discharge on behalf of their client as an incident of the retainer. Since the client was obliged to reimburse Bakewells and that obligation was financed by the loan agreements and SPFL had a pre-existing arrangement with Bakewells, Bakewells was the supplier and the loan was a DCS agreement ([35]). The forms prescribed for a DCS agreement had not been properly worded and the loans were consequently irredeemably unenforceable.

21. In making his finding, the Judge relied on the analagous role of the travel agent, referred to in Guest and Lloyd, Encyclopaedia of Consumer Credit Law, Para 2-076 ([30]).

Default Interest as between the debtor and SPFL

22. It was common ground that no annual statements were supplied by SPFL contrary to the requirement of s.77A CCA. Consequently, the client had no liability for the interest during the period of non-compliance. This was in distinction to mere unenenforcebility, which on the Judges's findings did not allow Bakewells to avoid liability under clause 5.1 of MoA. SPFL was therefore disentitled to any sum of interest to the extent calculated by reference to the period of non-compliance (s.77A(6)(b)) and from a default sum which would have become payable during the period of non-compliance (s.77A(6)(c)).

THE CONTRACTUAL ISSUES

23. Bakewells argued that clause 5.1 operated as a guarantee in that it guaranteed payment of the sums due from the clients under the loans. As no sums were due under the loans, because they were irredeemably unenforceable, no liability arose under the guarantee. It further argued that, on the facts of the case, the loans had been varied thereby releasing it as a guarantor. In the alternative, if clause 5.1 imposed a primary obligation, it did not apply when the unenforceability is attributable to SPFL's error. It also argued that, as the loans were unenforceable from their inception, there was never any obligation to repay any sums.

24. Relying upon the principles set out in *ICS v West Bromwich BS* [1998] 1 WLR 896, the judge reached the following conclusions as to the issues of interpretation that had been raised:

    a) there was nothing in the language of the parties that evidenced an intention that Bakewells would undertake to see that the clients would perform their primary obligations under the relevant loan agreements ([54]);
    b) the language used suggested positively that creating a guarantee obligation was not the intention because the obligation arose not merely in the event of a breach, but in the event that an obligation of the clients had become unenforceable ([55]);
    c) all parties knew at all times that the loans would only come into existence if there had been a relationship of solicitor and client or such a relationship had been about to come into existence, and thus that the issue concerning unenforceability would or at

least could arise at a time when that relationship had still been subsisting ([56]);

d) the language was consistent only with a primary obligation to pay an ascertainable sum on the occurrence of either trigger event, not to pay damages for breach of an obligation to see to it that the clients complied with their obligations under the loan agreements ([57]).

e) Bakewells's construction of clause 5.1 to limit liability where the unenforceablily was the result of a failure on its part or from the outset was commercially absurd. Bakewells's obligation to pay was an obligation to pay either in the event of breach by the clients or in the event that the relevant loan agreement was unenforceable.

f) Bakewells relied upon clause 2 of the MoA which contained a warranty that the forms supplied by SPFL would be "appropriate". It submitted that this meant that the forms would comply with the requirements of the CCA. As they did not, SPFL acted in breach of warranty and Bakewells was entitled to set off any sums it might owe under clause 5.1. HHJ Pelling QC rejected this submission on the basis of the construction of the clause as a whole ([69]-[71]).

g) There was no reason to imply any terms to qualify clause 5.1 ([72]-[73]).

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CONCLUSION

25. Given HHJ Pelling QC's conclusion that clause 5.1 was not a guarantee, a number of further CCA issues become hypothetical and the judge decided not to investigate them. The issues will nonetheless probably arise in the future and are worth mentioning:
    a) whether the mere unenforceability of an underlying obligation is sufficient to bar a claim under a guarantee of that obligation ([58] – [62]).
    b) whether s.82 CCA[6] creates an exception to the rule that any material variation to the terms of the principal contract will discharge the surety where the application of s.82 renders the variation unenforceable ([63] – [64]).

26. Although this case largely adressed issues arising on old forms of agreement under which non-compliance can give rise to irredeemable unenforceability, there remain many agreements where such unenforceability is still an issue, and further the decision addresses issues of general importance, particularly as to who is a supplier and what is the effect of having a fixed sum of interest in an agreement for a maximum rather than a fixed term.

[6] Section 82(2) has the follwing effect. The original agreement is revoked. The varied agreement stands as a new agreement containing the combined effect of the two agreements. It is also a regulated agreement.

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