Supreme Court imposes sense on Unfair Relationships

By Paul Skinner

In *Plevin v Paragon Personal Finance Ltd* [2014] UKSC 61 the Supreme Court has clarified various aspects of the law of Unfair Relationships under ss.140A-140C of the Consumer Credit Act 1974. In doing so, it has however created some uncertainty as to precisely when a relationship may be unfair, in particular due to a creditor's omissions.

INTRODUCTION

1. In *Plevin v Paragon Personal Finance Ltd* [2014] UKSC 61, handed down on 12 November 2014, the Supreme Court has taken the opportunity to consider in some detail the provisions of the Consumer Credit Act 1974 ("**CCA**"), which allow the courts to exercise a wide range of powers in relation to credit agreements where the debtor is an individual and which it considers are unfair.

2. In doing so, it has overturned the decision of the Court of Appeal in *Harrison v Black Horse Ltd* [2012] Lloyd's Rep IR 521 ("**Harrison**") and, in overruling the Court of Appeal below, has reduced the wide scope of circumstances in which a relationship could have been unfair by reason of the acts of intermediaries. While Lord Sumption, whose judgment the other members of the Court agreed, attempted to give some guidance as to what was required for a relationship to be unfair, he has left significant questions unanswered.

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3. After outlining the background to unfair relationships and the facts of the case, this Alerter examines the approach of the Supreme Court to:

   a. The regulatory regime;

   b. Voluntary codes;

   c. Unfairness arising from omissions;

   d. The meaning of 'by and on behalf of';

   e. Secret commissions; and,

   f. Suitability assessments.

BACKGROUND

4. Sections 140A-140C of the CCA were introduced by the Consumer Credit Act 2006 and replaced (with some transitional provisions) sections 137-140 CCA, which had enabled courts to reopen "extortionate credit bargains" "so as to do justice between the parties" (s.137(1)). The government's decision to replace extortionate credit bargains with unfair relationships was expressly to "*make agreements easier to challenge*"[1].

5. In essence, the courts have broad powers under section 140B where it has determined that the relationship between the creditor and the debtor arising out of the agreement is unfair. A credit agreement may be unfair because of any of the following:

   a. its terms;

   b. the way in which the creditor has exercised or enforced any of his rights under it; and/or

[1] Department for Trade Industry White Paper, *Fair Clear and Competitive – The Consumer Credit Market in the 21st Century,* December 2003

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c. "*any other thing done (or not done) by, or on behalf of, the creditor (either before or after the making of the agreement…*".

6. Importantly section 140A(3) provides that "*…the court shall (except to the extent that it is not appropriate to do so) treat anything done (or not done) by, or on behalf of, or in relation to, an associate or a former associate of the creditor as if done (or not done) by, or on behalf of, or in relation to, the creditor*".

FACTS

7. *Plevin* was one of the many cases that creditors have had to deal with relating to the sale of Payment Protection Insurance ("**PPI**"). Although Mrs Plevin's unfair relationship case had been pleaded rather more complicatedly, by the time it reached the Court of Appeal (and Supreme Court) it had been narrowed down to two essential point, namely that the agreement was unfair because:

   a. The high level of commission (78.1% of the insurance premium) that the insurer paid to the credit broker and the creditor was not disclosed to her; and

   b. She had not been advised by Paragon or the credit broker as to the PPI policy's suitability for her in circumstances where it was plainly not suitable for her.

8. Before considering whether she was correct to argue those, it was necessary for the Supreme Court to explain various aspects of the law.

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ANALYSIS

Relevance of the Regulatory Regime

9. One of the most controversial aspects of the law of unfair relationships in recent years has been the Court of Appeal's decision in *Harrison* that the "*touchstone*" as to whether a relationship was unfair or not was "*the standard imposed by the regulatory authorities pursuant to their statutory duties*" rather than *"resort to a visceral instinct that the relevant conduct is beyond the Pale.*" (at [58]). The reason for this, Lord Justice Tomlinson explained was that "*[i]t would be an anomalous result if a lender was obliged to disclose receipt of a commission in order to escape a finding of unfairness under s.140A of the Act but yet not obliged to disclose it pursuant to the statutorily imposed regulatory framework under which it operates.*"

10. After *Harrison,* if the debtor could not point to a breach of the regulatory regime, as found in the Financial Conduct Authority's Handbook, the Court was virtually bound to find that there was no unfair relationship.

11. The Supreme Court considered that *Harrison* was wrong. Lord Sumption (with whom the other members of the Court agreed) held (at [17]) that,

> *"The view which a court takes of the fairness or unfairness of a debtor-creditor relationship may legitimately be influenced by the standard of commercial conduct reasonably to be expected of the creditor. The [regulatory rules] are some evidence of what that standard is. But they cannot be determinative of the question posed by section 140A, because they are doing different things. The fundamental difference is that the [regulatory, here ICOB] rules impose obligations on insurers and insurance intermediaries. Section 140A, by comparison does not impose any obligation and is not concerned with the question whether the creditor or anyone else is in breach of a duty. It is concerned with the question whether the creditor's relationship with the debtor was unfair. It may be unfair for a variety of reasons, which do not have to involve a breach of duty. There are other differences, which flow from this. The ICOB rules impose a minimum standard of*

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conduct applicable in a wide range of situations, enforceable by action and sounding in damages. Section 140A introduces a broader test of fairness applied to the particular debtor-creditor relationship, which may lead to the transaction being reopened as a matter of judicial discretion. The standard of conduct required of practitioners by the [regulatory] rules is laid down in advance by the Financial [Conduct] Authority, whereas the standard of fairness in a debtor-creditor relationship is a matter for the court, on which it must make its own assessment. Most of the [regulatory] rules, including those relating to the disclosure of commission impose hard-edged requirements, whereas the question of fairness involves a large element of forensic judgment. It follows that the question whether the debtor-creditor relationship is fair cannot be the same as the question whether the creditor has complied with the [regulatory] rules, and the facts which may be relevant to answer it are manifestly different. An altogether wider range of considerations may be relevant to the fairness of the relationship, most of which would not be relevant to the application of the rules. They include the characteristics of the borrower, her sophistication or vulnerability, the facts which she could reasonably be expected to know or assume, the range of choices available to her, and the degree to which the creditor was or should have been aware of these matters."

12. In short summary:

    a. The regulatory regime is now relevant but not determinative;

    b. A variety of factors which are not relevant to the question of the compliance with the regulatory regime are relevant to the fairness of the relationship, in particular the debtor's personal circumstances.

13. This may prove problematic for creditors. Particularly in circumstances where there is a credit broker or Independent Financial Advisor, the creditor may not have considered the personal circumstances of the debtor, but may now be found to be in an unfair relationship because an aspect of the agreement can be seen to be unfair in light of them. Lenders will need to take stock of this and consider whether they require to know more about a potential debtor in the circumstances where the regulatory regime does not impose a particular obligation on them to do so.

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Relevance of voluntary codes

14. Paragon and the credit broker were each members of the Finance Industry Standards Association ("**FISA**"). Paragon was also a member of the Finance & Leasing Association ("**FLA**"). Mrs Plevin argued that the FLA Lending Code (2004) and the FISA Codes and Disciplinary Procedures were relevant to the question of when an act was done "by or on behalf of" the creditor. The Supreme Court disagreed with her on this point, but did consider that they could in principle berelevant. Lord Sumption said,

> *"the codes have no legal status except as between the associations and their members. They have no statutory force. They formed no part of the contractual distribution of responsibilities…The most that can be said about them is that they may be some evidence of what constitutes reasonable standards of commercial conduct in this field."*

15. Voluntary codes are generally entered into by industry groups on the understanding (and indeed sometimes for the reason) that they do not impose legal duties on them. The effect of *Plevin* is that these codes can now have some legal effect in providing evidence as to whether a relationship was fair or not. Lenders who have entered into such codes will need to consider whether any code to which they have signed up (or, more accurately, whether their failure to adhere to any such code) may later come back to haunt them in the guise of an unfair relationship claim.

Unfair omissions

16. One of the issues that had not been considered in any detail in determining whether a relationship was unfair was whether there was any difference between acts and omissions. In relation to positive acts done by or on behalf of a creditor which make a relationship unfair, "*this gives rise to no particular conceptual difficulty*." Something which a creditor actively does

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which may be unfair is easy enough to spot. However, Lord Sumption considered, "*the concept of causing a relation to be unfair by not doing something is more problematical*." This was because, in light of his analysis of the relationship between unfair relationships and regulatory duties, *"[i]t necessarily implie[s] that the Act treats the creditor as being responsible for the unfairness which results from his inaction, even if that responsibility falls short of a legal duty*."

17. So what is the test that the courts must consider when it is said that a relationship is unfair by reason of something not done? Lord Sumption concluded as follows:

"the creditor must normally be regarded as responsible for an omission making his relationship with the debtor unfair if he fails to take such steps as (i) it would be reasonable to expect the creditor or someone acting on his behalf to take in the interests of fairness, and (ii) would have removed the source of that unfairness or mitigated its consequences so that the relationship as a whole can no longer be regarded as unfair."

18. Whilst this is conceptually tidy, in practice it is likely to cause creditors some difficulty as it is uncertain in two respects:

    a. First, what is reasonable to expect a creditor to do is something which will vary according to the particular factual circumstances and cannot therefore be solved through general processes; and,

    b. Second, given that unfairness is to be judged by the courts retrospectively, whether any particular step has removed the source of unfairness or mitigates it such that the relationship is no longer unfair is one which will often be difficult for creditors to be sure of in advance of a judge determining the matter in court.

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Creditor's liability for whom?

19. While the aspects of *Plevin* discussed above pose certain potential problems for creditors, the Supreme Court has reduced significantly their liability for others' acts and omissions, at least where the regulatory scheme expressly allocates responsibility for that act to another.

20. A relationship may be unfair because of any thing done or not done "by or on behalf of" the creditor. The Court of Appeal had held that this provision "was designed to bring within the purview of the court's consideration any relevant act or omission by a person who, in a non-technical sense, would be viewed by the man on the Clapham omnibus as having played some part in the bringing about of the credit agreement for the creditor" (at para 48).

21. This was extremely broad and the Supreme Court has brought the scope of this provision back within its proper limits, namely those who act as the creditor's agent or deemed agent. Lord Sumption gave three reasons for this:

    a. First, the statutory language was clear. "On behalf of" normally imports a meaning of agency and there was nothing to suggest that this is what was not meant here.

    b. Second, the CCA makes extensive use to imputing responsibility to the creditor for the acts or omissions of parties who are not (necessarily) the creditor's agent. Had it been intended that "on behalf of" would expand responsibility beyond a creditor's agent, the CCA would have done so expressly.

    c. Third, there are no coherent criteria to enable a court to determine when the test which the Court of Appeal had laid down would be satisfied.

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22. This will no doubt come as a relief as the Court of Appeal's decision on this issue had the potential to extend the scope of a creditor's liability very widely. In this case, it was the acts of a credit broker that were in issue, but there is no reason why under the Court of Appeal's test a creditor could not have been liable for the acts and omissions of an independent financial advisor. The Supreme Court has re-imposed coherence on this issue.

Undisclosed commissions

23. Returning to the facts of *Plevin* the Supreme Court considered that the relationship between Mrs Plevin and Paragon was unfair. It did so simply because the amount of commission was undisclosed to her. As Lord Sumption said, "*A sufficiently extreme inequality of knowledge and understanding is a classic source of unfairness in any relationship between a creditor and a non-commercial debtor. It is a question of degree. Mrs Plevin must be taken to have known that some commission would be payable… But at some point commissions may become so large that the relationship cannot be regarded as fair if the customer is kept in ignorance. At what point is difficult to say, but wherever the tipping point may lie, the commissions paid in this case* [71.8%] *are a long way beyond it.*"

24. It was then necessary to consider whether the relationship was unfair by something done or not done by or on behalf of the creditor. Lord Sumption considered that the failure to disclose commission was the responsibility of Paragon as they "*were the only party who must necessarily have known the size of both commissions*." It would, given the commission's significance to Mrs Plevin's decision, have been reasonable to expect them to disclose it. "*Had they done so this particular source of unfairness would have been removed because Mrs Plevin would then have been able to make a properly informed judgment about the value of the PPI policy*." (para 20)

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Suitability Assessments

25. Mrs Plevin's second argument was that Paragon had to assess the suitability of the policy for Mrs Plevin's needs in order for the relationship to be fair. The Supreme Court held that it did not:

    a. The first question was whether it was reasonable in the interests of fairness to expect Paragon to assess Mrs Plevin's needs themselves, notwithstanding the absence of any legal obligation to do so. Lord Sumption held that Paragon could not reasonably have been expected in the interests of fairness to conduct their own needs assessment. This was because, although not decisive, the regulatory framework was highly relevant. This was because it expressly assigned the duty to carry out such an assessment to the credit broker. *"Paragon could not reasonably have been expected to perform a function which the relevant statutory code of regulation expressly assigned to someone else."*

    b. The second question is whether the credit broker's failure to do so could be said to have been "by or on behalf of" Paragon. Given the narrower conclusion that Lord Sumption reached on the meaning of "by or on behalf of the creditor", he concluded that it could not.

CONCLUSIONS

26. Broadly, the Supreme Court's judgment is to be welcomed. Whilst it imposes a degree of uncertainty on individual cases, it provides some useful guidance, in particular that the regulatory regime, whilst relegated from a touchstone, is still relevant, at least in so far as it actively imposes duties on intermediaries rather than creditors. Particularly welcome for creditors will be the narrower definition adopted of "by or on behalf of".

27. The Supreme Court decided to remit the case back to the Manchester County Court to decide what relief was appropriate under s.140B. Given

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the number of cases such as this in which the extent of commission has not been disclosed and which are therefore likely to give rise to an unfair relationship, no doubt the extent of the remedy awarded will now become of greater importance.

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