Author Richard Mawrey QC

NOSIA than thou? Unenforceability provisions in consumer credit regulations

KEY POINTS

- Unenforceability is now the sanction of choice for most consumer-orientated legislation, but it is often triggered by trivial errors or computer glitches.
- The Consumer Credit Act (CCA) 1974 ss 77A and 86B which regulate the serving of annual statements for fixed-sum credit agreements and notices of sums in arrear (NOSIA) carry disproportionate sanctions for non-compliance, particularly where the prejudice to the customer is minimal.
- Every unenforceable agreement diminishes the pool of money available for lending and increases the costs of the lender which are passed on to those customers who do meet their obligations.
- In place of total unenforceability, why not make these penalties subject to the same regime as the improperly executed agreement – enforcement with court leave?

Richard Mawrey QC examines whether the penalties for non-compliance with the Byzantine labyrinth of the Consumer Credit Act 1974 are reasonable, necessary or proportionate.

As a general rule, ought contracts to be enforceable? Lord Melbourne, who was Prime Minister from 1834 to 1841, certainly thought so:

> "The whole duty of government is to prevent crime and to preserve contracts."

What a refreshing view and how far have modern governments departed from that ideal. Indeed we seem to have departed from his sensible and pragmatic view of life in other ways. He once sternly admonished his cabinet:

> "Gentlemen, it is not much matter which we say, but mind, we must all say the same."

But, then, unlike our own dear PM, Melbourne was a past master at managing difficult colleagues. Someone who could handle Palmerston and Lord John Russell would have had no trouble with Davis or Johnson. And, faced with Brexit, he might well have repeated his maxim:

> "Nobody ever did anything very foolish except from some strong principle."

The question "ought contracts to be enforceable?" is posed now because, unlike in Melbourne's time, the answer is not a given. The last century has seen an explosion of statutory and regulatory rules which are expressly designed to erode the principle that contracts should be enforceable. Most, but not all, of these rules are the result of pressure on governments by consumerists, for whom the concept of legally enforceable obligations voluntarily undertaken by citizens of full age and capacity is deeply distasteful. For many consumerists, the consumer is (*ex officio*) a victim, and the idea of his being able to make an informed choice to enter into a binding obligation risible. Any contract between a trader and a consumer is thus, *prima facie*, an exploitation of the latter by the former.

Now it could be said that the law has long prescribed formalities for certain legal transactions and has imposed unenforceability as the sanction for non-compliance. It would be paltering with the truth, however, to claim that this process was one of unbroken success. Witness the provisions of the Statute of Frauds 1677 s 164:

> "noe Contract for the Sale of any Goods Wares or Merchandises for the price of ten pounds Sterling or upwards shall be allowed to be good except the Buyer shall accept part of the Goods soe sold and actually receive the same or give some thing in earnest to bind the bargaine or in part of payment, or that some Note or Memorandum in writeing of the said bargaine be made and signed by the partyes to be charged by such Contract or their Agents thereunto lawfully authorized."

This provision was widely evaded and ended up being described as being as much an instrument of fraud as the mischief it was designed to counteract. It was eventually abolished together with most of the rest of the Statute.

The exponential growth of unenforceability provisions started with the Consumer Credit Act 1974 (CCA) and unenforceability is now the sanction of choice for most consumer-oriented legislation. Before looking at some particular aspects of it, however, it may be asked whether it does serve any long-term economic objective, beyond, possibly, some Marxist goal of the destruction of capitalism, though in the light of the present polarisation of British politics, that is by no means a fanciful question.

The first point to note is that the sanction of unenforceability falls primarily on the honest but occasionally careless trader who makes a genuine mistake. Dishonest traders or those who despise consumerist legislation are little troubled by unenforceability.

If, for example, your debt-collection involves a large man called Wayne with cauliflower ears, several scars and Doberman dog with attitude, unenforceability in the local County Court does not appear an unsurmountable problem. It is the harassed trader trying to make an honest bob who has neither the time nor the money to consult expensive consumer lawyers who finds himself with the short end of the stick.

A good example is to be found in the famous case of *Wilson v First County Trust Ltd* [2000] EWCA Civ 427. What made the case famous was that the Court of Appeal (virtually of its own motion) decided that CCA s 127(1)-(3), which rendered certain improperly executed agreements perpetually unenforceable in all circumstances, was incompatible with Art 6(1) of the 1950 Convention for the Protection of Human Rights and Fundamental Freedoms and Art 1 of the Protocol to the Convention – [2001] EWCA Civ 633. The case was appealed to the House of Lords who, by the exercise of the intellectual dishonesty for which it was famous, decided not only that the Convention did not apply (on the grounds that the Human Rights Act 1998 had not been passed when the CCA came into existence – hmmm) but also that this Draconian rule had been voted through by Parliament and must thus be compatible with the Convention (hmmm again). What is sometimes forgotten is how Mrs Wilson got there in the first place.

Mrs Wilson, being a bit strapped for cash, decided to pawn her BMW 318 convertible with a pawnbroker operated by First County. The loan was £5,000 and there was a fee of £250 which First County treated as added to the loan. In the regulated consumer credit agreement (which was otherwise compliant) First County, logically and in accordance with what was a very common view of the CCA and the Consumer Credit (Agreements) Regulations 1983, treated the £5,250 as being the credit provided and documented the agreement accordingly. Failure to state the amount of the credit correctly was a hanging offence, irremediable under s 127. After prolonged argument, the Court of Appeal first time round – [2001] QB 407 – decided that the agreement should have stated the credit to be £5,000 and the £250 as part of the charge for credit. Although there were (and are) very good arguments for saying that this is wrong and makes a nonsense of documenting agreements, for our purposes this is irrelevant. What is relevant is that First County (an entirely reputable pawnbroker) in an area where there was not, at the time of the agreement, any decided law, arrived at a construction of the CCA and the Agreements Regulations which turned out not to persuade the Court of Appeal. It was not suggested that the construction placed on the statute by First County had been fanciful or obviously wrong nor was it suggested that the statutory provisions were so crystal clear as to admit of only one construction. The Court of Appeal was doing its job and trying to bring clarity to a disputed piece of statutory construction. It was the appalling consequences of this honest mistake rendering the agreement wholly unenforceable so that Mrs Wilson kept both the car and the money that led the court to invite argument at a subsequent hearing as to whether CCA s 127(1)-(3) was compatible with the Convention.

The second point, which flows from the first, is that over-elaborate and difficult to construe statutory provisions turn what should be ordinary commerce into some sort of computer game where there are endless pitfalls and traps, any of which can, so to speak, cause you to explode. The game is, of course, only one way. There are no circumstances where the consumer can find himself debarred from enforcing against the trader except, conceivably, under the Limitation Acts. This invites the question: "ought everyday agreements between traders and their customers to be operated as a game where the slightest mis-step by the trader, however honest or non-negligent (eg an unforeseeable computer glitch) deposits a huge undeserved windfall on the customer?"

Third, is the absolute inflexibility of the rules necessary for the protection of the consumer? The documents concerned are, after all, intended for the protection of the consumer but turning them into a minefield for the trader does not improve that protection. All that the inflexible nature of the rules does is to give the sharp, the dishonest or the feckless consumer an uncovenanted piece of good luck.
A good test of the necessity of the rules is to have a look at the 1993 Agreements Regulations as amended in 2004 and which came into force in May 2005 (SI 1983/1553, amended 2004/1482). These rules carried complication to the point where in other walks of life one would be calling for consultant psychiatrists specialising in Obsessive Compulsive Disorder. Information had to be displayed in a rigid, inflexible order with compulsory headings and endless warning boxes, information boxes etc, all of which had to be letter perfect. Any deviation rendered the agreement unenforceable (though some might be enforceable if one went cap-in-hand to the court and asked for an enforcement order). And the 2004 Disclosure Regulations (SI 2004/1481) obliged the creditor to produce a virtual clone of the intended agreement in advance, thus doubling the opportunities for fatal errors.

And then the folk in Brussels forced us to adopt the Consumer Credit Directive – Directive 2008/48/EC. The British Government did not like this one little bit. It sulked like a teenager and eventually implemented the barest minimum it could get away with and did so nine months late. What did the Eurocrats do? They replaced the pre-contract disclosure nightmare of the CCA with the SECCI (Standard European Consumer Credit Information) and the ECCI (European Consumer Credit Information) – lengthy but easily comprehensible documents with considerable flexibility as to how to complete them. The whole complex rigmarole of regulated agreements, which would have appeared over-complicated to Constantine VII Porphyrogenitos (*De Imperio Administrando, 948*, and *De Ceremoniis*, 956, of course), was jettisoned in place of a simple list of information clearly expressed.
Did the sky fall? No. Was there a vast increase in debtor/victims claiming to have been lured into crippling credit agreements

for lack of pre-contract disclosure as per the old CCA rules or for lack of the formalities of the 1983 Agreements Regulations? Still no. All that the consumerists had achieved with the CCA and its statutory instruments was to provide a lot of shyster claims farmers and dubious lawyers with the opportunity to exploit the gullible with illusory promises to "get you off your debts". Is one permitted to say "Brussels got it right" or would that make one an Enemy of the People?

In short, inflexible formulae do not benefit the consumer and never did.

Lastly, how does the imposition of all these prescriptive rules with unenforceability as a sanction impact on the wider economy? Most developed societies and all capitalist societies function on the basis that contracts voluntarily made are legally enforceable. Any form of economic life would be impossible without it. The voluntary element is that of entering into the contract: you are not compelled to do it – you *choose*. Once you have made the choice and entered into the contract you are bound. The performance of your obligations is not voluntary. If I buy a car from you and pay you the purchase price, I expect you to hand over the car. I do not expect you to say "I choose not to hand over the car but I will keep your money anyway". If you did, I could sue you, whether for the delivery of the car or repayment of the purchase price is irrelevant. A court would order you to fulfil your obligations and penalise you if you did not.

What happens if, as happens in the consumer credit industry, a significant number of agreements are visited with unenforceability by reason of inadvertent or even fault-free mistakes in attempting to comply with a huge volume of technical rules which have been crafted in the hope and expectation that the trader will fail to comply with them? Whatever may be said about other sectors of the economy, there is a sense in which credit is an n-sum game. The amount of money available to be lent to consumers by any one lender is not infinite. The lender's business depends on the debtor paying interest on the loan and repaying the capital in due course. Naturally there will always be bad debts. This is true in all walks of commerce but the prudent trader can factor them into his business and, provided they do not get out of hand, survive them. If some inadvertent error causes a large number of agreements to become unenforceable, then it can spell ruin. The loss to the lender, however, is ultimately the loss to the customer. If the money does not come back to the lender, it cannot be lent out again.

Every unenforceable agreement diminishes the pool of money available for lending and increases the costs of the lender, those costs being passed on to lenders by way of higher charges. The bad debtor – the dishonest or feckless debtor – puts up costs for the good debtor who pays his interest and repays his capital. It is hard to see how a system which sets out to create bad debts for the lender is benefitting the economy in any way. Would any highway authority, however politically motivated, go out and deliberately *create* potholes in the road?

In criminal law, sanctions are generally applied in accordance with the gravity of the offence and, most importantly, the degree of culpability of the defendant. This is why causing death by careless driving – an offence of negligence – is, in general, punished less severely than murder – an offence of intention. Another important consideration is the effect on the victim. A man who takes a swipe at his adversary with a baseball bat and misses or simply causes a small bruise is likely to be penalised less than one who connects with his victim and splits his head open. In the vast majority of cases where agreements are rendered unenforceable the culpability of the lender is negligible and the prejudice to the debtor infinitesimal. Indeed most debtors do not discover that some non-compliant document has been served on them until some smart-ass lawyer draws it to their attention. Yet it can enable an undeserving debtor to scoop the jackpot.

One of the biggest headaches for lenders is the need to serve annual statements for fixed-sum credit agreements under CCA s 77A and notices of sums in arrear under s 86B. The problem is less acute with running account agreements (s 86C), largely because these tend to have regular (usually monthly) statements as part of the system – credit cards being the classic example.

Nobody would quarrel with the general principle that a debtor with a long term fixed sum loan should be sent regular statements. The idea that those who fall into arrears should be sent statements by creditors who do not want to chase debts at any given time or to enforce the loan by court action is much more controversial. If it were the case that a loan agreement could be terminated and proceedings started without serving a notice or any prior warning on the debtor, then one might well argue that this was unsatisfactory and would penalise the debtor who intends to pay and simply forgets or is having some form of problem with his bank account. But this has never been the case with regulated credit agreements. While it has always been theoretically possible for a creditor to sue simply for accrued arrears of instalments without serving a notice, any more stringent form of enforcement has always required service of a notice under CCA ss 87 and 88, the forms for which have been prescribed since the Act was fully implemented in May 1985. Furthermore, some form of general pre-action protocol in debt cases has been the norm for some years and has now morphed into the Protocol XIII about which this column has complained in the past.

Why then must the debtor receive constant arrears notices when the creditor is not proposing to act on them? This is all bound up with the consumerist notion of the debtor as victim. The ordinary citizen is as a little child, hopeless with money and quite incapable of managing a loan agreement. It is a peculiarly British notion. The provisions for statements and notices pre-date the EU Consumer Credit Directive and have no equivalent in the Directive.

And just to make sure that the process is really complex, difficult and mutually incomprehensible to the creditor and the debtor, we produced the snappily titled Consumer Credit (Information Requirements and Duration of Licences and Charges) Regulations 2007 – SI 2007/1167. It is the combination of these regulations with the statutory provisions in CCA s 77A

Feature

Biog box
Richard Mawrey QC is a barrister practising from Henderson Chambers, Temple, London, specialising in commercial law, financial services and credit and leasing.
Email: rmawrey@hendersonchambers.co.uk

and 86B that cause weight loss and hair falling out for respectable financers and luxurious holidays for consumer lawyers. For the debtor they are a source of confusion tempered by the lottery that their creditor's computer might have a hiccough as a result of which they will receive a large cash windfall.

The reason for all this angst is that the sanctions for non-compliance are such that even Draco would feel uneasy. The key to the arcade game is that there is a severely (and irrationally short) window within which steps have to be taken by the creditor both for annual statements under s 77A and for notices of sums in arrears (always lovingly referred to as NOSIA for the first in the series or SNOSIA for subsequent). If you fail to beat the deadline you enter into a period of non-compliance during which:

- the agreement becomes unenforceable; and
- interest ceases to run; and
- default sums cease to be payable.

The beauty of it is that even if you think you have beaten the deadline but the statement or NOSIA you have served is non-compliant, because one of the Byzantine rules has not been complied with to the letter, then your document is as the empty air. A non-compliant statement is a statement that is not 100% compliant – it is all or nothing. If the statement is non-compliant, it is a nullity and you are in the same position as if you had served nothing – *JPMorgan Chase Bank v Northern Rock* [2014] EWHC 291 (Ch). You may not discover this for (literally) years but the fact remains that you have been non-compliant all this time. And the chances are that your debtor has not noticed it either so he (or some claims farmer on his behalf) will not be yapping for a cash handout. It may only come to light when an audit is carried out – often when a book of debts is sold by one creditor to another.

It is not as if the 2007 Regulations are a model of clarity. Far from it. Consumer credit experts argue over the meaning of "interest" in the various contexts and the true decryption of the provisions for aggregated agreements would baffle Bletchley Park. What the appellate courts would make of all this is the stuff of nightmares.

And they have additional pitfalls for the unwary. A NOSIA is triggered by an absurdly small level of arrears – in general, two missed payments, which, in the case of running-account agreements, may not even mean two wholly missed payments. There is then an equally absurd period of 14 days to send the NOSIA – or non-compliance descends. But, and this is the icing on the cake, even if the debtor pays off his arrears before the NOSIA is sent, *it still has to be sent!* So, Mr Debtor neglects to pay the instalments due on 1 June and 1 July. NOSIA triggered and must be sent by 15 July. On 6 July Mr Debtor wakes up and says "OMG, I forgot to pay while I was on holiday" and sends the creditor a cheque. Imagine his chagrin when, on 15 July he receives through the post a NOSIA in all its glory accompanied by a highly patronising – Janet-and-John-go-to-the Citizens'Advice-Bureau – "information sheet" issued by the FCA.

As my old friend Marcus Tullius Cicero used to say "*cui bono?*" Who wins? Answers on a postcard to the Consumer Lawyers' Lamborghini Fund.

You have to ask: what is the point of all this rigmarole? Is any real social or economic purpose being served by rendering agreements, voluntarily entered into, unenforceable and by handing defaulting debtors substantial uncovenanted windfalls of cancelled interest? How many debtors actually read their annual statement under CCA s 77A with all its information boxes about partial repayment and the like? Does any debtor spot he has not been sent a NOSIA until some wily claims farmer points it out to him? Why make the Regulations so complicated that you are setting up the creditor to fail?

The answer must surely be to go down the route now followed (albeit reluctantly) with CCA ss 127(1) to (3). Abolish the concept of total unenforceability and automatic cancellation of interest and have the penalties imposed by the CCA subject to the same régime as the improperly executed agreement. The creditor should be able to go to court and show that the failure to serve the statement or the NOSIA (or a compliant version thereof) was due to some minor glitch or reasonable misunderstanding of the law and that the debtor has not been prejudiced. The court would then have a discretion whether to permit enforcement and deny the debtor his interest payout or penalise the creditor and make him go through the hoops of re-serving the statement, NOSIA or whatever. Naughty creditors would be justly punished, and unfortunate well-meaning creditors given relief. Why not?

Lord Goff of Chieveley was fond of quoting the old legal maxim "*res magis valeat quam pereat*" to counsel who were arguing that an agreement was too vague to be enforced. "It is better to make the thing work than to junk it". The cerebral Lord Goff would have had little in common with the cynical hedonist Lord Melbourne, but they would both agree that the enforcement of contracts is the bedrock of the Rule of Law. ■

Further Reading:

- Consumer credit: "taking back control"? (2018) 3 JIBFL 170.
- Adversary or inquisitor: Judicial intervention in consumer banking litigation (2016) 8 JIBFL 466.
- LexisPSL: Financial Services: Consumer credit regime – overview.