Broken bridge in unfair relationship case withstands jealous scrutiny

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Dispute Resolution analysis: Despite interwoven personal relationships, the Court of Appeal has ruled that a secured loan agreement did not amount to an unfair relationship. Russell Kelsall, partner in the litigation and financial services practice group at Squire Patton Boggs (UK) LLP, comments on the consequences of the decision in McMullon v Secure the Bridge Limited for consumer credit businesses.

Original news

McMullon v Secure the Bridge Ltd [2015] EWCA Civ 884, [2015] All ER (D) 79 (Aug)

The Court of Appeal ruled that a secured loan agreement did not amount to an unfair relationship even where a business coach of the customer (who had provided training and support to her to enable her to start up her own business) had a major shareholding in a lender that provided a substantial bridging loan to the customer. Although the Court of Appeal found that the relationship was inappropriate and the lender had benefitted from the relationship, it declined to interfere with the trial judge's ruling that the relationship was not unfair within the meaning of the Consumer Credit Act 1974, s 104 (CCA 1974). It upheld the earlier ruling given by Recorder Cadwallader in Leeds and Bradford County Courts (unreported) on 28 January and 17 March 2014. The Court of Appeal declined to interfere with the trial judge's decision that, applying his discretion to the facts as he determined them from the evidence at trial, the relationship between Mrs McMullon and the lender was not unfair.

However, the Court of Appeal made one concession in that it reduced the interest payable and substituted as the relevant rates of interest payable 1.5% per month pre-judgment and 8% per annum post-judgment. The interest rate in the contract was 4% per month.

What were the facts in this case?

Mrs McMullon was financially over-committed. Mr McMullon's business supplying timber framed buildings had gone into administration. Mrs McMullon had an empty buy-to-let property in Huddersfield. Mrs McMullon had started a new business (Rainbow Property Sourcing Ltd) which too was to supply timber framed buildings. She had seven credit cards and owed £39,000 in total on them. She had a mortgage on her main home of £138,000 and this was said to be worth £450,000. A number of applications for a decision in principle (DIPs) had been made on her behalf unsuccessfully for further lending.

Mrs McMullon wanted to obtain short term bridging finance with Secure the Bridge Ltd (the lender). Her plan was to get a bridging loan to pay off her credit card debts in full. When this was done, she wanted to apply for a remortgage to pay off her main mortgage and the bridging loan. The lender granted Mrs McMullon a secured bridging loan of £25,000. This provided for Mrs Mullen to pay interest (called a facility fee) of 1.5% per month. The bridging loan was for three months. If it was not repaid, the interest rate was 4% per month (or 48% per year). The application for a remortgage was unsuccessful. Mrs McMullon disputed any liability to pay interest under the bridging loan after the first three months. The bridging loan was a regulated consumer credit agreement under CCA 1974 as it was made with an individual.

There are some complications in the facts that need drawing out as well. Mrs Mullen had spent nearly £13,744 on a finance, property and business course and this had added to her debt problems. This course was provided by a company called The Wealth Academy. Mr Lindsay Hopkins worked as a trainer for The Wealth Academy and provided post-course coaching to Mrs McMullon and encouraged her with her Rainbow Property venture. Mr Hopkins also had a 48% shareholding in the lender which provided the bridging finance.

Mrs McMullon's only income was from care allowance, child tax credit and disability living allowance. On the lender's internal fact find (that Mrs McMullon had neither seen nor signed) her annual income was stated to be £27,392 including rental income from her empty buy-to-let house and £18,000 from Mr McMullon. The fact find did, however, record her credit card liabilities correctly. The fact find was completed by a Mr Yardley who worked for a broker (Trafalgar Square Financial Planning Consultants) of which Mr Hopkins was the principal.

What did the trial judge find?

Mrs McMullon defaulted on the bridging loan. The lender brought a county court claim to recover the £25,000 bridging loan, interest and costs. Mrs McMullon defended the claim and put in a counterclaim. In this she alleged that there was an 'unfair relationship' under CCA 1974, s 140A and that the court should make an order under CCA 1974, s 140B either reducing the amount claimed or absolving her of any liability to pay anything more.

After hearing all the evidence, including some very testing cross-examination of the three critical witnesses (Mrs McMullon, Mr Hopkins and Mr Yardley), the trial judge (Mr Recorder Cadwallader) rejected Mrs McMullon's defence. He makes a number of findings in a lengthy reserved judgment. Some of these proved critical on the appeal and included the following findings in relation to Mrs McMullon:

- she was 'ready to say anything more or less plausible in the hope of achieving her objective'
- the inaccuracies in the documentation 'were Mrs McMullon's responsibility'
- she had not been rushed into signing the bridging loan
- the bridging loan was the lender's standard form document with no unusual clauses
- the evidence of Mr Yardley and Mr Hopkins had been 'consistent' and was to be preferred to hers
- although she was desperate to obtain a remortgage or bridging loan, 'she was a very determined person...which was amply bourne out by my observation of her in the witness box', and
- she knew what she was doing and had only herself to blame

What arguments were made on appeal?

Two arguments were made on appeal. The first is that the trial judge was wrong to find that there was not an unfair relationship because of the multiple roles that Mr Hopkins had and its propensity to give rise to unfairness. This was split out into three grounds of appeal:

- Mr Hopkins had a conflict of interest in being Mrs McMullon's coach--his lending business profited from the bridging loan a substantial part of which was used to pay off the cost of her course that another of Mr Hopkins' companies had provided
- Mrs McMullon was dependent on state benefits and could not afford the bridging loan
- the lender's fact find was deficient

The other argument on appeal related to the interest clause in the bridging loan. After three months, this provided that the interest would be 4% a month. CCA 1974, s 93 provides that interest is not to be increased on default and CCA 1974, s 173 provides that a term in a regulated consumer credit agreement which is inconsistent with CCA 1974 protections is void. Mrs McMullon said not only that the interest rate could not be increased from 1.5% to 4% a month, but that, properly construed, the bridging loan contained no valid provision for any interest to be charged after the initial three-month period.

What did the Court of Appeal rule?

The Court of Appeal declined to interfere with the trial judge's findings. It found that the Recorder's findings of fact were clear. Mrs McMullon had not been misled in any way and she was determined to obtain this bridging loan as a route to re-organising all her debts. As the trial judge had heard the evidence and found that the relationship was not unfair, the Court of Appeal agreed and said, despite the unusual facts in this case, this was not an unfair relationship under CCA 1974, s 140A.

The main judgment was given by Hildyard J and his conclusion on the unfair relationship issue is as follows (at para [77]):

'I have concluded that there is no proper basis for this court to gainsay or disturb the Recorder's findings of fact and conclusions on these matters. I have concluded further that those findings of fact, together with his determination (in effect) that it was the urgency of the Appellant's need and desire for the re-mortgage, and her determination to do whatever was necessary to achieve her objective, which led to the Credit Agreement, rather than any abuse of position, undue influence or non-disclosure on the part of the Claimant, sufficiently support his decision that the relationship between the parties arising out of that agreement was not unfair to the Appellant.'

It is not all good news because in a short additional judgment Underhill LJ, obiter, remarks as follows (at para [93]):

> 'I agree. This is undoubtedly a troubling case. Two points are of particular concern. The first is that, in the light of the previous "coaching" relationship between Mr Hopkins and the Appellant, he should have arranged for her to obtain a loan from a company in which he had a 48% interest, and all the more so when the loan was obviously high-risk for her and very profitable for the company. The second is that both the documents completed in connection with actual or potential applications were so dramatically inaccurate...I would not, however, want this Court to give the impression that it is either good practice or legally safe for advisers in positions analogous to that of Mr Hopkins in this case to enter--themselves or through associated companies--into credit agreements with their clients. On the contrary, the Court is likely to subject any such relationship to jealous scrutiny; the fact that in the particular circumstances of this case the Respondent survived that scrutiny does not mean that that will necessarily be the outcome in most--perhaps not even in many--other such cases arising out of relationships of this kind.'

On the interest charging point, the Court of Appeal ruled that interest on a regulated consumer credit agreement cannot be increased on default. It over-turns the Recorder's findings and as a matter of construction finds that the bridging loan agreement has no valid provision to charge interest after the initial three-month period. In an endeavour to fill the gap, the Court of Appeal decided that these interest rates can be used instead:

- 1.5% per month from the end of the three-month bridging loan period to the grant of judgment (noting that Mrs McMullon had had the use of the money and had saved interest on her credit card debts), and
- 8% per annum on any judgment debt under the County Courts (Interest on Judgment Debts) Order 1991, SI 1991/1184 (the 1991 Order)--but this part of the judgment is rather odd because interest is not recoverable on a money judgment on an agreement regulated by CCA 1974--see art 2(3)(a) of the 1991 Order

How does this decision clarify the interpretation of the Consumer Credit Act 2006?

Although the ruling in the *Harrison v Black Horse Ltd* [2011] EWCA Civ 1128, [2011] All ER (D) 112 (Oct) was subsequently over-ruled in *Plevin v Paragon Personal Finance Ltd* [2014] UKSC 61, [2015] 1 All ER 625, some aspects of the first appeal ruling remain intact. These include a prescient observation from HHJ Waksman QC in the High Court decision in *Harrison v Black Horse Ltd* [2010] EWHC 3152 (QB), [2010] All ER (D) 131 (Dec) (at para [50]):

> 'The process involves an assessment of facts and the balancing and weighing of different factors which is classically an exercise for the Judge at first instance. For my part, save where it is quite plain that the Judge has failed to consider an obviously relevant matter or taken into account an obviously irrelevant factor, or proceeded on an erroneous view of the law, an appellate court should be most reluctant to interfere. After all, UR claims are often made in relatively low value cases, frequently heard in the fast track, and it is desirable that they should be conducted simply and speedily.'

Here, the Recorder had conducted that assessment, balancing and weighing of the factors. He was well-placed to do so as he heard the evidence, judged the demeanour of the witnesses, observed how this stood up in cross-examination and noted any inconsistencies with documents or previous statements. Not surprisingly, the Court of Appeal declined to interfere with the assessment conducted by the trial judge. However, once again, it is difficult to see that an appeal court has set any precedent which will weigh strongly in future cases.

The warning from Underhill LJ is clear that the lender here may have had a lucky escape. The facts in this case are quite unusual. However, where there are interwoven personal relationships that lead to lending that is governed by CCA 1974, these will be subject to jealous scrutiny in the future to ensure that the relationship between the lender and borrower is not rendered unfair as a result.

It is also worth noting that Mrs McMullon was running a business and that while this was a consumer loan, its underlying purpose was to help her business get off the ground. The courts have taken a different approach in deciding whether there is an unfair relationship where the context is business lending. In *Deutsche Bank (Suisse) SA v Khan* [2013] EWHC 482 (Comm), [2013] All ER (D) 195 (Mar), Hamblen J ruled that the lending was not an unfair relationship as the debtor had negotiated changes to the terms originally proposed by the bank.

Paragon Mortgages Ltd v McEwan-Peters [2011] EWHC 2491 (Comm), [2011] All ER (D) 65 (Oct) concerned lending to buy to let investors. Again, David Steel J declined to find the relationship was unfair noting that there was neither an improper motive nor an arbitrary decision by the lender in its decision to enforce the loan contracts. Most recently, in *Barclays Bank plc v McMillan* [2015] EWHC 1596 (Comm), [2015] All ER (D) 104 (Jun), Popplewell J held that a $540,000

loan to an attorney was not an unfair relationship because there was no misrepresentation or duress. The interest rate was clearly stated which was neither an unreasonable nor unfair rate and provided for tax relief too.

What did the court decide in relation to the provisions of the credit agreement?

The Court of Appeal construed two of the terms of the bridging loan agreement:

- condition 6--fees--which provided for a fee (effectively interest) of 1.5% per month during the first three months
- condition 7--which provided for interest at the rate of 4% per month after this initial period

The Court of Appeal over-turned the Recorder's ruling on this. It found that, properly construed, this particular bridging loan agreement did not contain a valid interest charging provision after the initial three-month period was up. Recognising that this would cause an injustice, as Mrs McMullon had reduced her outgoings, the Court of Appeal decided that the lender could charge 1.5% interest per month up to judgment and then interest at the judgment rate of 8% per annum afterwards (but this latter finding seems wrong because of art 2(3)(a) of the 1991 Order).

What was the Court of Appeal's approach to the Supreme Court decision in Plevin v Paragon Personal Finance Ltd?

Plevin is an unsatisfactory decision in many ways. For an appeal that went to the country's highest court, its decision on what is or is not an unfair relationship is very narrow and based on the specific facts. Neither the Court of Appeal nor the trial judge could take very much from it in deciding the fact-sensitive unfair relationship question.

Plevin has, however, proved to be of immense value in clarifying on whose behalf a broker acts 'on behalf of'. The Supreme Court over-ruled the Court of Appeal on this and restored the sensible ruling of the trial judge. The *McMullon* case straddled the *Plevin* appeal--by the time the case was heard in the Court of Appeal it had the benefit of Lord Sumption's judgment in *Plevin* on what 'on behalf of' meant. This then proved damaging to Mrs McMullon's appeal because she could no longer maintain that the acts or omissions of the broker (Trafalgar Square Financial Planning Consultants) and/or its employee, Mr Yardley, were done 'on behalf of' the lender, Secure the Bridge Limited.

What should lawyers take from this case?

The most important take-away is to emphasise the importance of getting the case presented correctly at trial. Appeal courts are very reluctant to disturb factual findings on appeal. Despite the defects in the fact find, the loan was still held to be enforceable. Lenders should not be complacent on compliance because the judge only reached this conclusion because he found Mrs McMullon to have been determined to obtain this bridging loan. Where there are interwoven personal relationships that could influence lending decisions or decisions to enforce loan agreements, then these have the potential to cause an unfair relationship. Underhill LJ makes clear that lower courts must subject these sorts of cases to jealous scrutiny.

Both the Court of Appeal and the recorder looked at where the burden of proof lies in unfair relationship cases. Hildyard J said (at para [13]) that 'the burden is squarely on the creditor'. With respect to the Court of Appeal, this is not quite right and the true position is a little more nuanced. Although Hildyard J refers to the judgement of Peter Smith J in *Bevin v Datum Finance Ltd* [2011] EWHC 3542 (Ch) on the burden of proof, this is a decision made without proper consideration of the law. It is criticised in the text books as wrong and comes to opposite conclusions raised by HHJ Waksman QC in *Carey v HSBC Bank plc* [2009] EWHC 3417 (QB), [2010] All ER (D) 05 (Feb) and Swift J in *Axton v GE Money Mortgages Ltd and another* [2015] EWHC 1343 (QB), [2015] All ER (D) 39 (Jun). While a defaulting debtor can claim that the relationship is unfair, they have to provide some particulars as to why this is the case before the legal or persuasive burden of proving why the relationship is not unfair shifts on to the lender. This approach is entirely consistent with other burdens of proof in other contexts (see, for example, the Employment Rights Act 1996, s 98(1) for unfair dismissal cases).

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