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Does lending by a family run business to a builder need FCA authorisation?

Newmafruit Farms Limited v. Alan Pither
[2016] EWHC 2205 (QB)

Article by David Bowden

Does lending by a family run business to a builder need FCA authorisation?

A successful fruit farm business made a series of loans over many years to a builder and companies he controlled. These loans totalled £1.75million. The majority of the loans were to finance building projects both in England and Florida that the fruit farm and builder were undertaking by way of a joint venture. The builder either spent the cash or diverted the funds elsewhere. The fruit farm brought an action to enforce the loans. On a summary judgment application, the judge granted judgment for £1.5million. In relation to the other loans the judge said there were triable issues. This included whether the fruit farm needed authorisation from the FCA to exercise its rights under regulated consumer credit agreements. The builder said the fruit farm did not have a licence from either the OFT or authorisation from the FCA to conduct consumer credit business. The fruit farm will have to show that the lending to the builder was not carried on by way of business to be exempt from FCA authorisation. The judge also ruled that none of the credit agreements complied with the formalities under the Consumer Credit Act 1974. Finally the judge ruled it was inappropriate to rule on an application for an enforcement order on a summary basis.

Newmafruit Farms Limited & others v. Alan Pither & others
[2016] EWHC 2205 (QB) 9 September 2016
High Court of Justice, Queen's Bench Division (Deputy Judge Martin Chamberlain QC)

What are the facts?
Mr Newman is a director and major shareholder in Newmafruit Farms Limited ('Newmafruit'). Mr Peter is an accountant and used to be Newmafruit's finance director. Mr Peter is a long standing friend of Mr Pither (a property developer) and acts as his personal accountant. From 2008 Newmafruit began to generate substantial profits and built up substantial cash reserves. Mr Peter suggested to Mr Newman that Newmafruit could earn a better return on its money by lending directly to businesses and entrepreneurs. It therefore made loans of varying amounts not only to Mr Pither but also to others including Mr & Mrs Gosling, Mr Peter and various corporate entities.

What was the lending for?
Newmafruit lent substantial sums to Mr Pither and his companies. These sums were advanced to complete property development projects in Kent, Essex, Norfolk and Florida. Mr Pither had scarcely undertaken any building work but rather had used the money to fund his other business ventures or to pay his personal expenses. On 20 June 2011 Newmafruit and Mr Pither entered into an agreement which provided for repayment of the lending by 20 June 2013. The lending was not repaid.

What action did Newmafruit Farms bring?
Newmafruit brought an action to recover the sums totaling nearly £1.75million it had lent to Mr Pither. The judge granted summary judgement for nearly £1.5million but said there were defences in relation to £250k of the lending that could go forward to trial.

Mr Justice Jay on 22 July 2016 granted a worldwide freezing injunction against Mr Pither's assets and ordered him to disclose all his assets to Newmafruit. Newmafruit made claims against Mr Pither and his companies alleging:

- Deceit,
- Breach of fiduciary duty,
- Dishonest assistance,
- Conspiracy,
- Breach of contract, and
- Unjust enrichment.

On what basis did Mr Pither seek to defend these claims?
Mr Pither sought to defend Newmafruit's action to enforce its loans. This defence fell into these categories:

- Some lending was made to limited companies (now insolvent) for which Mr Pither had no personal liability,
- Newmafruit needed regulatory authorisation to be able to make loans which it did not have,
- Newmafruit needed an enforcement order from a court to enforce unenforceable loans which it was not suitable to determine on a summary basis,
- Newmafruit's loans were unenforceable because it had neither complied with the requirements of the Consumer Credit Act 1974 ('CCA') on loan agreements nor had it provided account lifetime information mandated by the CCA to Mr Pither, and
- Newmafruit had waived its entitlement to recover these loans or was estopped from doing so.

What were the issues before the court?
The 8 issues the court had to decide were:

- Should Mr Pither be allowed to amend his defence and counterclaim to make the new CCA related allegations?
- To which entities were the loans made and was Mr Pither responsible for loans made to corporate entities?
- Had Mr Pither agreed to repay any of the lending in the past?
- Did Newmafruit need either a consumer credit licence or authorisation from the FCA to make these loans?
- Were the loans Newmafruit made by way of business?
- Was Newmafruit carrying on by way of business the activity of exercising rights under CCA regulated agreements?
- Could a court make an enforcement order to allow Newmafruit to enforce on a summary basis?
- Had Newmafruit complied with the documentation and information requirements that the CCA imposes on lenders and the corresponding rights that this gives to borrowers?

What grounds did Newmafruit Farm advance as to why it should be able to enforce its loans?
Newmafruit produced evidence from its bankers showing where all the payments had been made. On the whole these were sent to Mr Pither directly but some funds were sent to attorneys acting on Mr Pither's behalf. It said the lending had not been repaid. It also relied on the 2011 agreement in which Mr Pither agreed to repay the money in 2 years' time.

What did the Consumer Credit Act 1974 say about the need for a consumer credit licence?
Until 1 April 2014 section 21(1) of the CCA provided that a licence was required to '*carry on a consumer credit business'*. Section 40 of the CCA said that a regulated consumer credit agreement was '*not enforceable against the debtor*' where a creditor was not licensed. Section 189 of the CCA defined '*consumer credit business'* as being '*any business being carried on by a person so far as it comprises or relates to (a) the provision of credit by him, or (b) otherwise his being a creditor'*. However s189(2) of the CCA provided a carve-out where a lender was not treated as carrying on a lending business '*merely because occasionally he enters into transactions belonging to a business of that type'*.

The position under the CCA was therefore clearer for those in the position of Newmafruit who had lent money to a builder who was building something for it in a joint venture. The commentary written by Professor Eva Lomnicka in '*Guest and Lloyd: Encyclopedia of Consumer Credit Law'* notes a number of appellate decisions on this including:

- *Shahabinia v. Giyahchi* **(16 June 1988) QBD** – lending on 4 occasions over one year to 1 customer did <u>not</u> constitute the carrying on business under the (now repealed) Moneylenders Acts,
- *Regina v. Marshall* **(1990) 90 Cr App R 73** (Court of Appeal) – the question of whether a person enters into transactions 'occasionally' is a matter of fact and degree for a court to decide. The transaction did not have to be part of his way of doing business rather than merely providing assistance to his customers,
- *Hare v Schurek* **[1993] CCLR 77** (Court of Appeal) – a one-off loan by a car dealer to a customer did not constitute the carrying on a consumer credit business, and
- *Tamimi v Khodari* **[2009] EWCA Civ 1109** (Court of Appeal) – a series of large loans over 6 years in a private context by a banker to foster the relationship with an important client at gambling clubs was also held not to have been made '*in the course of business'*.

How did this change when the Financial Conduct Authority started to authorize consumer credit business?
On 1 April 2014 the FCA started to regulate consumer credit business. A large amount of the CCA was repealed and put into a badly written rulebook (which has proved to be far more difficult to understand or navigate) called **CONC**. At the same time a statutory instrument ('RAO') came into force called the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment No 2) Order 2013 **SI 2013/1881.** Rather than merely copy over the well-trodden exemption for occasional lending in the CCA, the FCA thought it knew better and foisted something even worse on lenders instead.

However this has to be seen in context of the '*general prohibition'* in section 19 of FiSMA 2000 which prohibits the carrying on a '*regulated activity'* without either permission from the FCA or by an exempt person. Section 26(1) of FiSMA provides that an '*agreement made by a person in the course of carrying*

on a regulated activity in contravention of the general prohibition is unenforceable against the other party'. Article 48(2) of the RAO provides that a '*relevant agreement is not enforceable against a debtor…by a person carrying on a regulated activity*'. Article 60B of the RAO then defines '*regulated credit agreements*' as a '*specified kind of activity for the lender …to exercise, or have the right to exercise, the lender's rights and duties under a regulated credit agreement*'.

Section 22 of FiSMA provides that an activity is a regulated activity where it is '*an activity of a specified kind which is carried on by way of business*'. Part II paragraph 23 of the RAO then defines this activity as a regulated where 'rights under any contract under which one person provides another with credit' and it defines '*credit*' as '*any cash loan or other financial accommodation'*.

What does the FCA's Perimeter Guidance say? Are there any exemptions?
FiSMA states the extent of the very large area that the FCA regulates. However the FCA has issued guidance as to what is meant to happen at what it terms the 'perimeter' of this regulated area. This is set out in its Perimeter Guidance Manual (**PERG**). **PERG 2.3.3G** states:

> *'Whether or not an activity is carried on by way of business is ultimately a question of judgment that takes account of several factors (none of which is likely to be conclusive). These include the degree of continuity, the existence of a commercial element, the scale of the activity and the proportion which the activity bears to other activities carried on by the same person but which are not regulated. The nature of the particular regulated activity that is carried on will also be relevant to the factual analysis.'*

In **PERG 4.3.3G**, the FSA says that the difference between the '*carrying on the business'* test and the '*by way of business test' 'should have little practical effect'* but at **PERG 4.3.6G** the FCA identifies some distinctions.

What had the Court of Appeal previously ruled in *Helden v Strathmore*?
The meaning of the phrase '*carried on by way of business'* in FiSMA was considered. The Court of Appeal said **[2011] EWCA Civ 542** that there is a distinction between (a) an activity '*carried on by way of business',* and (b) carrying on *'the business of engaging in that activity'.* In relation to some activities such as arranging or advising on regulated mortgage contracts), the RAO provides that an activity is only to be treated as regulated if the person carries on the business of engaging in that activity. But where an activity is not so specified such as exercising a lender's rights and duties under a regulated credit agreement, a looser requirement applies. Here it is only necessary to show that the activity is '*carried on by way of business'*.

Are there any other authorities of relevance?
There are 3 authorities that the judge considered in deciding whether Mr Pither should be allowed to amend his defence at this late stage to make all the technical points under CCA or FiSMA. These are:

> *Swain-Mason v. Hillman* **[2001] 2 All ER** (Court of Appeal – Lord Woolf MR)
> In determining a summary judgment application, the question is whether a defendant has a '*realistic*' as opposed to a '*fanciful*' prospect of success. The court must not conduct a mini-trial.
>
> *ED& F Man Liquid Products v. Patel* **[2003] EWCA Civ 472** (Court of Appeal – Potter LJ)
> A defence must carry '*some degree of conviction'* and be '*more than merely arguable'*. It is for a claimant to establish that a defendant has no real prospect of success. That does not mean that a court has to accept without analysis everything said by a party in his statements before the court. In some cases, there may be no real substance in factual assertions made, particularly if contradicted by contemporaneous documents. If so, issues which are dependent upon those factual assertions may be susceptible of disposal at an early stage so as to save the cost and delay of trying an issue the outcome of which is inevitable.
>
> *JSC VTB Bank v. Shurikhin* **[2014] EWHC 271** (High Court, Simon J)
> Some disputes on the law or the construction of a document are suitable for summary determination, since if it is bad in law the sooner it is determined the better. On the other hand it may not be appropriate to decide difficult questions of law on an interlocutory application where the facts may determine how those legal issues will present themselves for determination and/or the legal issues are in an area that requires detailed argument and mature consideration.

Did the judge allow Mr Pither to amend his defence? What factual determinations did he make?
Yes. When the judge applied *Swain-Mason*, he had to accept that Mr Pither's defence to enforcement of some of the loans (representing 15% by value) had a realistic prospect of success. Mr Pither was therefore permitted in relation to these loans to plead points in relation to the CCA/FiSMA as to their enforceability which claims (unless settled or compromised) will have to progress for trial at a later date.

In relation to a number of loans, when the judge examined the evidence particularly the bank transfers he decided that these loans were made to corporate entities and not to Mr Pither personally. Even giving the 2011 agreement its most generous interpretation, he ruled that for some loans Mr Pither was not personally liable.

The judge also ruled that Mr Pither agreed to repay lending of over £1.4million when he entered in the June 2011 agreement. Where Mr Pither now sought to say otherwise the judge ruled this was '*unclear and inconsistent'* and a purported defence otherwise lacked the necessary '*degree of conviction*' and should not be allowed.

What ruling did the court give on whether Newmafruit Farms need authorisation from a regulator to lend money?
The judge went through the provisions in the CCA, FiSMA and the RAO and ruled that in relation to a tranche of loans amounting to around £250k by value that the issue of whether Newmafruit needed permission from the FCA to lend money could go forward to trial and that the proposed amended defence and counterclaim on this from Mr Pither (although appearing late in the day) had a *realistic* prospect of success but required the determination of a number of other factual issues.

Did the judge manage to exclude any lending from his ruling?
Yes. This fell into 4 distinct categories:

- In relation to some loans, Newmafruit had lent money not to Mr Pither but rather to a corporate body than he controlled. For these, the judge correctly noted that these agreements were not regulated consumer credit agreements because they were not made to an '*individual*' and thus were out of scope because of sections 8(1) and 189(1) of the CCA
- The judge had to consider lending in relation to Quail West in Florida where the funds were sent by Newmafruit to Mr Pither's attorney in Florida. The judge ruled that this is a 'regulated agreement' but this cannot be right because the territorial scope of the CCA is only the UK but the judge does not pause to consider this nor indeed are any of the timeshare cases on this point cited to him.
- For some lending the judge correctly finds that the agreements between Newmafruit and Mr Pither were '*exempt*' agreements under s16B of the CCA because the amount of the credit was for more than £25,000 and the regulated limit under the CCA at the time of the lending was £25,000 or less.
- For the final tranche of loans, the judge said that on the material before him it was not possible to say whether the sums were borrowed by Mr Pither or not but he noted that it seemed '*likely that they were borrowed wholly or predominantly for the purposes of Mr Pither's business*'.

What ruling did the judge give on whether Newmafruit made these loans by way of business?
Here the judge had to decide whether the lending by Newmafruit to Mr Pither was '*carried on by way of business*'. He also had to decide if Newmafruit was '*carrying on by way of business the activity of exercising rights under regulated agreements'*. The judge said if Newmafruit was, then any such credit agreements would be unenforceable against Mr Pither because of Article 48(2) of the RAO.

On this enquiry the judge said that the FiSMA 2000 (Carrying on Regulated Activities by Way of Business) Order 2001 **SI 2001/1177** did not assist him in determining whether Newmafruit was exercising a lender's rights under a regulate credit agreement or not. Instead the judge referred extensively to both the first instance decision of Newey J **[2010] EWHC 2012 (Ch)** as well as the Court of Appeal decision in *Helden v. Strathmore*. Newey J had extensive regard to PERG in his judgment noting that whilst PERG was not binding on the courts it was still of interest. Pulling the strands of **PERG** and *Helden* together, the judge decided that:

> '*it is not necessary for Mr Pither to show that the exercising of lender's rights under regulated agreements represented for Newmafruit the carrying on a business in its own right. The test is the looser one of whether the activity of exercising lender's rights under regulated agreements was carried on by Newmafruit "*by way of business*". The latter test could be (though would not necessarily be) satisfied even if the activity were undertaken "*on an isolated occasion*" only*.'

The judge noted that '*Mr Newman's evidence does not address the extent to which Newmafruit is currently engaged in the activity of exercising its rights as lender under these agreements'*. He went on to conclude on this issue there was a triable issue saying that:

> '*In the light of this evidence, and applying the looser test explained by Newey J in* Helden v Strathmore*, it is impossible to say, in respect of the sums lent pursuant to regulated agreements, that Mr Pither has no real prospect of establishing that Newmafruit is acting "*by way of business*" in exercising its rights as lender under these agreements. Given the relevant factors identified, the judgment referred to in* ***PERG 2.3.3G*** *could only be made on much fuller information.'*

What did the judge say about whether Newmafruit had complied with the CCA documentation and information requirements?
Here the judge had to consider 2 well-known parts of the CCA. The first being section 61 which mandates in conjunction with statutory instruments the form and content of a regulated consumer credit agreement. The second being the corresponding provisions in section 55 about pre-contract information. (It should be noted here that the judge did not consider the CCA provisions in relation to either annual statements or notices of sums in arrears that have to be provided to customers during the lifetime of a regulated agreement).

On this the judge was clear and concise ruling that:

> '*It is common ground that none of the agreements giving rise to the debts claimed by Newmafruit in this action was preceded by the required disclosure and none of them was executed in the prescribed form.'*

What does the Consumer Credit Act 1974 say about enforcement orders?
Section 127 of the CCA gives a court a power to grant an enforcement order where there has been a breach or non-compliance with the CCA including where an agreement is not made in the prescribed form. It says that '*the court shall dismiss the application, if but only if, if it considers it just to do so having regard to (i) prejudice caused to any person by the contravention in question, and the degree of culpability for it; and (b) the powers conferred on the court by subsection (2) and sections 135 and 136*.'

Section 127(2) empowers a court where '*it appears just to do so'* to '*reduce or discharge any sum payable*'. Section 135 gives the court a power to impose conditions or suspend the operation of any court order whilst s136 empowers it to include '*such provision as it considers just for amending any agreement or security in consequence of a term of an order'*.

What ruling did the court give on the enforcement order application? Can it be determined summarily?
Counsel for Newmafruit made a brave submission that on all the facts presented here it would be obvious that an enforcement order would be made against Mr Pither and it would only delay the inevitable agony to postpone this to another day. Sadly the judge did not agree and he ruled:

> *'The multi-factorial assessment required by s. 127 when deciding whether to permit enforcement seems inherently unlikely to be possible on an application for summary judgment. Certainly on the evidence before me on this application, I do not see how I could form a clear view on either the prejudice caused to Mr Pither by enforcement or the degree of culpability on Newmafruit's part for the various contraventions of the regulations. As far as it relates to the regulated agreements, the Disclosure/Information Defence therefore raises a triable issue*.'

Will there be an appeal?
This ruling was handed down on 9 September 2016. Any appeal would go to the Court of Appeal and to be in time an application for permission would need to be lodged by 30 September 2016. Newmafruit has obtained summary judgement for nearly £1.5million representing over 85% of its claim against Mr Pither. It is likely to take a commercial view and progress enforcement of what it has obtained judgement for against Mr Pither and to seek compliance with the asset disclosure order made under its freezing injunction.

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David Bowden is a solicitor-advocate and runs David Bowden Law which is authorised and regulated by the Bar Standards Board to provide legal services and conduct litigation. He is the cases editor for the Encyclopedia of Consumer Credit Law. If you need advice or assistance in relation to consumer credit, financial services or litigation he can be contacted at info@DavidBowdenLaw.com or by telephone on (01462) 431444.