Plevin v. Paragon Personal Finance Ltd – the implications for UK asset finance brokers

Written by David Bowden
Published: 13 November 2014
Created: 13 November 2014

David Bowden asks: "Do independent brokers act on behalf of lenders when assessing if a lending relationship is unfair?

On November 12, 2014, the Supreme Court of the United Kingdom handed down its reserved judgment in the case of Plevin v. Paragon Personal Finance.

This is the first time that the UK's highest court has had to consider the "unfair relationships" provisions that were enacted by the Consumer Credit Act 2006.

Although this case arose in the context of a Payment Protection Insurance (PPI) mis-selling case, one of the two issues that the Supreme Court had to decide will be of particular interest to those involved in the provision of asset finance.

This is whether an independent broker acts on behalf of a lender or not – and if so what the consequences will be.

The judgment of the Supreme Court will be welcomed by lenders on this agency point but should correspondingly give some cause for concern to brokers.

The facts of the case

A broker (Loan Line) put an unsolicited leaflet through an end-user customer's letter box. The broker offered to arrange refinancing at competitive rates. The broker assessed the customer's "demands and needs" for payment protection insurance as it was required to do under the FSA (now FCA) Insurance Conduct of Business Rules.

The broker was one of 11 brokers that a lender (Paragon) dealt with. Paragon accepted the business and conducted money laundering checks (in a "speak with" telephone call) but did not conduct any assessment of the suitability of the insurance itself.

The loan was for £34,000 at a highly competitive APR of 7.3% with loan payments spread over 10 years. The loan agreement was on the lender's standard documentation.

It was regulated by the Consumer Credit Act 1974 and secured by a second legal charge over her home.

Single premium PPI was arranged – this was for five years and not the full 10 year period of the loan. The PPI cost £5,780 of which 71.8% was retained as commission. The insurance was provided by Norwich Union. The broker received £1,870 commission (32%), the lender £2,280 (39%) and the balance went to the insurer.

The broker was a member of FISA – the Finance Industry Standards Association (which no longer exists). The lender subscribed to the voluntary FLA Lending Code 2004.

The customer was sent a FISA Guide.

There were no issues with the customer paying her mortgage.

Proceedings were brought in 2009 by the customer's solicitors against both the lender and the broker alleging initially that there were breaches of fiduciary duty and then subsequently that the PPI had been mis-sold in some way. A number of other claims were made which were either abandoned or dismissed at trial.

The broker went into insolvent liquidation. The claim against the broker was settled for £3,000. This was paid by the Financial Services Compensation Fund.

It is not clear why the claim was not settled in full.

This left the claim against the lender. The trial judge in Manchester County Court (Recorder Yip QC) dismissed all claims after a four-day trial. The judge found there was not an "unfair relationship" and made an indemnity costs order in the lender's favour.

The customer appealed and in December 2013 the Court of Appeal allowed that appeal.

It found that the insolvent broker had acted on the lender's behalf, there was an "unfair relationship" and remitted it all back to the county court to determine compensation and costs.

The lender appealed to the Supreme Court – which is the final court of appeal for all civil cases in the United Kingdom. Its judgment therefore applies to all lending made in England, Wales, Scotland or Northern Ireland.

Two Supreme Court issues

There were two issues for the Supreme Court to decide. The first was whether receipt of commission (here 72%) by a lender could render a relationship unfair even though the FSA's rules did not require disclosure.

The Supreme Court over-ruled the 2011 Court of Appeal decision in Harrison v. Black Horse Limited and said that non-disclosure of commission could render a lending relationship unfair – especially where the amount paid to the insurance company was less than one-third of the price paid by the end user consumer.

It is worth noting here a few over-arching points the Supreme Court makes about "unfair relationships" (UR) and lending practices generally in its unanimous judgment:

• What must be unfair is the relationship between the customer and the lender. Where the terms themselves are not intrinsically unfair, this will often be because the relationship is so one-sided as substantially to limit the customer's ability to choose;

• Matters relating to a lender are relevant to a UR assessment. There may be features which operate harshly against the debtor – but it does not necessarily follow that the relationship is unfair. These factors may be required in order to protect what the court regards as a legitimate interest of the creditor;

• Unfairness must arise from either (a), (b) or (c) of section 140A of the CCA;

• The great majority of the relationships between commercial lenders and private borrowers are probably characterized by large differences of financial knowledge and expertise. But it cannot have been Parliament's intention that the generality of such relationships should be liable to be reopened for that reason alone.

Under ICOB (Insurance Conduct of Business) the obligation to assess suitability of the insurance product was with the intermediary who was in direct contact with the customer. As this was the broker – the lender had no responsibility to assess this suitability.

The customer sought to argue in the Supreme Court (as she had done in the Court of Appeal) that the broker had acted on the lender's behalf (and not just on her behalf).

This of course falls in the face of both common sense and long established commercial principles.

The broker held a licence from the OFT to carry on credit broking, it was a separate limited company (with no shareholders or directors in common with the lender), and it had its own FSA authorization for general insurance broking.

The broker was in direct contact with the customer. The broker searched its panel of lenders when seeking out the best deal for the customer. Whilst the broker received a commission from the lender – this is common in the insurance industry. The customer did not pay any upfront fees to the broker – and so would expect the broker to be paid by someone for its work.

"By or on behalf of the lender"

Section 140A (1)(c) of the CCA provides that a: "court may make an order… in connection with a credit agreement if it determines that the relationship between the creditor and the debtor arising out of the agreement…is unfair to the debtor because of …(c) any other thing done (or not done) by, or on behalf of, the creditor (either before or after the making of the agreement or any related agreement)."

The question for the Supreme Court was whether what the broker did (or did not do) was something done "by or on behalf of" the lender.

For business regulated by the CCA 1974, section 56 creates a deemed agency which means that in relation to restricted-use credit agreements (including hire purchase business) negotiations between a dealer and a customer are deemed to be made in the capacity of agent of the lender as well as in the capacity of the dealer itself. This deemed agency does not apply to leasing or consumer hire business.

Where there is a deemed agency under section 56, there is no automatic right of indemnity for a lender against a broker. This is in sharp contrast to connected lender liability under section 75 of the CCA (which applies to debtor-creditor-supplier agreements such as purchases made on a credit card) where there is a right to indemnity under section 75(2).

The CCA does in section 184 define "associate" and in relation to companies says that where the same person controls both companies, then those businesses are associated.

But that was clearly not the case here.

The CCA is also clear in sections 57, 67, 69, 73 and 102 that a debtor's statutory rights of withdrawal from prospective agreements, cancellation and rescission may arise on account of the conduct of a broker whether or not the broker is the lender's agent or not.

The courts have had difficulty interpreting the words "on behalf of". In a tax case (Gaspet v. Ellis) Mr Justice Moses said it meant agency or something akin to agency.

However, Lord Sumption is clear that these words in section 140A need to be read more widely so that they bear meanings such as:

- "in the place of";
- "for the benefit of"; or
- "in the interests of".

However when the Supreme Court applies these more widely drawn tests it is clear and emphatic that an independent broker does not act on behalf of a lender for the purposes of URs under section 140A of the CCA.

The Supreme Court says it is not enough that a broker was “closely involved in the transaction on the creditor’s side” to be the agent of the creditor. The Supreme Court says that a broker is remunerated by commission paid by a lender and that this has often been criticized. However it is an almost universal feature of the business and it is of the utmost legal and commercial importance to maintain the principle that the source of the commission has no bearing on the identity of the person for whom the broker is acting or indeed the nature of the broker’s functions.

The Supreme Court unanimously overturns last year’s controversial Court of Appeal decision and finds instead that the broker did not act on behalf of the lender when it assessed the customer’s suitability for the insurance the broker recommended to her.

FLA Lending Code

Finally the Supreme Court had to deal with the industry codes and what weight it should attach to them.

In relation to the code of the now defunct FISA, it said it was “at critical points rather obscure”. The FLA Lending Code 2004 fared considerably better under its glaze. The Supreme Court accepted this code was concerned with lending and not insurance broking. The FLA Code is a voluntary one for the benefit of its membership and it has no statutory force. The Supreme Court says the existence of a voluntary code does not mean that there was then a shared responsibility between a lender and a broker.

Both lenders and brokers will be relieved by the finding at paragraph 39 of the judgment that a lender does not have to verify compliance with the FLA Code in each individual transaction. All it requires is that lenders have to satisfy themselves about the general standard to which the broker conducts its business.

What now?

The case now goes back to Manchester County Court to determine if any additional compensation is due to the customer. As over 50% of the commission has already been repaid by the FSCS, it seems highly likely that the court will not order any further compensation to be paid at all. If this happens, then a speculative case promoted by a Claims Management Company will fail and whichever after the event insurer stood behind this case will have to pay the lender’s costs which are already well into six figures.

Comments – brokers need to take care

Brokers need to take care when taking on new business that there is proper regulatory compliance. This is moreover the case now that the FCA CONC rulebook is fully in force. Lenders are not responsible for any failings by a broker where that responsibility is clearly laid at the door of a broker. Industry codes are voluntary but courts will still look at them. The importance of a broker maintaining good records cannot be over emphasized in order to be able to defeat claims which may appear many years after the business was written.

Whilst both single premium and point of sale PPI were banned by the FSA (which ban has been maintained by the FCA), brokers are still selling other general or life insurance products to which the same principle on commission disclosure will apply to avoid the finding there has been an unfair relationship.

It is very unhelpful that the Supreme Court has applied an economic test which means that the lower courts will have to look at and become arbiters of price in determining these cases. This is

a task that the UK government did not want to give courts and which they are presently ill equipped to deal with.

David Bowden is a Solicitor-Advocate and director of Promeritum Consulting Limited www.DavidBowdenLaw.com. He acts as a consultant to a number of banks, law firms, a credit reference agency and IT suppliers and has been a freelance consultant in this field since February 2004. He has wide experience in the finance industry having previously worked in-house for Lloyds Banking Group, Lombard, GE, Barclays/Woolwich and Santander UK. He can be contacted at: info@David-Bowden.com or by telephone on (01462) 431444.