Court of Appeal finds for Claimants in Landmark Motor Finance / Secret Commission Judgment

Motor Finance Claims

A person visits a car dealership. He finds a suitable vehicle. The company which operates the dealership is a registered credit broker, as well as a car dealer. As his broker, it arranges finance for him, which he uses to acquire the vehicle, or the use thereof. The lender subsequently pays a commission to the credit broker. The lender and the credit broker had a contract between them, to which the person was not a party, requiring the lender to pay the commission if the person entered into a finance agreement with the lender.

The credit broker had a financial incentive to introduce the prospective borrower to the lender. This may mean that the finance deal was not the best one available, but the borrower has found himself bound by its terms.

The credit broker also had a conflict of interests. On one hand, it could present information to the prospective borrower in an impartial and disinterested way, act loyally to him, and look for a better finance deal from another lender – meaning that he would be more likely to take the deal, and as a company it would be more likely to sell the vehicle. On the other hand, if the prospective borrower takes out finance with the lender, it will receive the commission.

The Court of Appeal found in favour of three claimants in this situation, in *Wrench v FirstRand Bank*, *Johnson v FirstRand Bank*, and *Hopcraft v Close Brothers*.

Between the cases, three types of claim were considered by the court:

- Secret commission / bribery
- Half-secret commission (accessory to a breach of fiduciary duty)
- Unfair relationship under s.140A of the Consumer Credit Act 1974

Secret Commission / Bribery Claims

For secret commission (bribery) claims to succeed, the court must find that there was <u>not</u> sufficient disclosure of the commission to the borrower, and that the credit broker owed a duty to the borrower to provide information, advice or recommendation on an impartial or disinterested basis ("the Disinterested Duty"). Remedies, which may include rescission of the agreement (meaning it will be unwound, restoring the parties to their pre-contractual positions), return of the commission and accounts of profits as necessary to give effect to the remedies, are available to the borrower as of right (subject to further applicable law / qualification beyond the scope of this article).

In respect of secrecy, the court held that commission clauses in finance agreements and pre-contractual information will not necessarily negate secrecy. The question is, in effect, one of whether there was sufficient disclosure – whether enough was done to make the prospective borrower aware of the commission. In *Wrench*, the court referred to the following factors in the course of the judgment, when deciding that the commission was secret (I advanced these points on Mr Wrench's behalf at first instance and on first appeal):

- The commission clause was buried in the small print

- Mr Wrench was asked to sign to confirm that he had read clause 10 of the Terms and Conditions, but not asked to sign to confirm he had read the commission clause (the requirement to read clause 10 served as a distraction)
- Mr Wrench did not read the terms and conditions
- There was no evidence that the commission clause was drawn specifically Mr Wrench's attention
- The Terms and Conditions were not expressly incorporated into the signed agreement (contrary to [33], this argument was run at first instance and on first appeal in *Wrench*)
- Mr Wrench was not told about the commission
- There was no direction to Mr Wrench to read the commission clause
- The commission clause was in a subclause of the Terms and Conditions
- It was unlikely that Mr Wrench would read the commission statement
- The commission clause was "a commission may be payable by us to the broker who introduced this transaction to us. The amount is available from the Broker on request." Mr Wrench was not a financially sophisticated consumer (in legal terms) and there was nothing to put him on notice that "broker" (with or without a capital letter) was a reference to the company which acted as the dealer selling the car

The court also observed:

- There was no specific direction from the lender to the credit broker to draw attention to the commission clause
- Mr Wrench did not sign a document to confirm that he had read information about the commission prior to entering into the credit agreement

A further factor was considered in the *Johnson* case as being relevant to disclosure:

- The credit broker had not certified that it told Mr Johnson of the commission

The court held that a commission would <u>not</u> be "fully" secret if the information was "*clearly and openly conveyed to any reader in a document that they deliberately do not read, especially if that document is designed for that purpose, they were directed to read it carefully, and they signed it."* (see at [110]).

In relation to the duty owed by the credit broker to the prospective borrower, the court held that the dealer/broker companies, acting as credit brokers, owed the Disinterested Duty to the claimants because they did not give full disclosure of the implications of the commission payment. It held at [87]:
"The very nature of the duties which the credit broker undertook gave rise to a "disinterested duty" unless the broker made it clear to the consumer that they could not act impartially because they had a financial incentive to put forward an offer from a particular lender or lenders. The broker could do this, for example, by saying: "I may offer you a product which may be chosen because it benefits me directly, even though it may not be the best product for you. Are you happy with that?" Of course, in most cases the disclosure would be more subtle than that; but it must be sufficient to bring home to the customer the fact that the person he is engaging to find an offer of finance is free to promote his own self-interest at the customer's expense."

"… in each case the offer from that lender was expressly or by necessary implication put forward as the most suitable (from the range of lenders ostensibly considered)" (see at [94]).

In turn, the court held at [92] that the Disinterested Duty gave rise to a fiduciary duty (the two go "hand in hand").

In *Wrench* and *Hopcraft*, the court held that the commission was secret, and that the dealer/broker company, in acting as a credit broker, owed to the claimants the necessary Disinterested Duty. In *Johnson*, whilst the court found that the commission had not been disclosed (see at [168]), the secret commission claim had been abandoned before the lower courts – see para [13].

Half-Secret Commission Claims

Half-secret commission claims typically involve sufficient disclosure of the fact that a commission would or may be paid, but not enough disclosure of the material facts to obtain the borrower's informed consent to the broker receiving the commission. A requirement for half-secret commission claims to succeed is that the credit broker owed the borrower a fiduciary duty. There is no requirement for a fee to paid by the borrower to the broker, or for a contract between them. The fiduciary duty will be breached by the credit broker receiving commission, and the broker will have no defence if the borrower's informed consent was not obtained. A claim can be brought against the lender where it can be shown that the lender was an accessory to the breach of fiduciary duty (it is not necessary to prove that the lender was an accessory in a "fully" secret commission claim, where the lender has primary liability). Remedies are available at the court's equitable discretion.

The court held:
"The question is not whether the brokers owed fiduciary duties at large; it is whether they owed such duties in relation to the specific tasks they undertook on behalf of the claimants. In our judgment they clearly did. Indeed in this context, it went hand in hand with the disinterested duty. All the judges in the lower courts were wrong to find that the relationship was not a fiduciary one."

"In all three of the present cases, just as the court decided on the fiduciary duty issue in Wood, there was an ad hoc fiduciary duty running in tandem with the disinterested duty, arising from the nature of the relationship, the tasks with which the brokers were entrusted, and the obligation of loyalty which is inherent in the disinterested duty."

Informed Consent

That the borrower gave informed consent to the payment of the commission is a defence to the breach of fiduciary duty.

Following the judgment, informed consent must be exactly that. Enough must be done to ensure that the borrower fully understands the fact of the commission, the amount, how the amount is arrived at, and the implications for him. There may be a difference in what needs to be done for experienced, wealthy investors and those who are not so financially sophisticated.

Accessory Liability

In relation to a claim against the lender for accessory liability, the court held that the burden of proving that the borrower gave informed consent would fall on the lender. It held that it should be no hardship for the lender to include, within the agreement it is entering with the borrower, the salient facts necessary to obtain informed consent. The lender had not done so. Since it would have known that broker would owe a fiduciary duty to the (unsophisticated) borrower, it effectively knew or deliberately turned a blind eye to the breach of fiduciary duty, and as such was an accessory.

Dealer/broker companies, when acting as credit brokers, will now have to give full disclosure of the implications of receiving commission if they wish to ensure they can defend the receipt of the commission where they owe the disinterested duty and/or a fiduciary duty. Lenders will need to do the same if they wish to avoid accessory liability.

Unfair Relationship Claims

Where the court finds a relationship between the lender and the borrower to have been unfair in accordance with s.140A of the Consumer Credit Act 1974, it may make an order under s.140B. This may include an order for the payment of a sum equivalent to the amount of the commission plus interest, the return of any overpaid interest in the finance agreement arising from the commission arrangement, or the consequences of rescinding the agreement – restitution subject to giving counter-restitution.

Johnson was the only case in which unfairness was a live issue before the court. The factors the court found to give rise to unfairness included:

- Non-disclosure of the commission
- That in effect Mr Johnson had ultimately paid the commission himself – the amount of credit required was higher and this was funding the payment of the commission (though the reasoning may be different to the specific logic set out by the court).
- Omission of a key fact / suppression of the truth – the failure to disclose to Mr Johnson that the broker had agreed to give the lender first refusal on offering him finance, before approaching any other lender. It had also given him a document indicating that it would have access to a panel of lenders and advise on a product which best met his needs (this was referred to as a document containing lies).
- The commission paid to the broker was 25% of the sum advanced (a very high commission may in itself be enough to make the relationship unfair where nothing, or nothing of substance, has been done to disclose the relationship between the lender and the broker).
- The sum borrowed and paid to the dealer was more than the car was worth.

Additional findings

A further significant finding was that CONC 4.5.3R is premised on a duty to be impartial: *"disclose to a customer the existence of any commission when knowledge of the existence or amount of the commission could actually or potentially (1) affect the impartiality of a credit*

broker in recommending a particular lender or (2) have a material impact on the customer's transaction decision".

This is likely to have an impact on how the regulation is interpreted in the future.

What next?

I have been instructed in around 180 motor finance cases such as these, over the past 18 months – including in the *Wrench* case at first instance and on first appeal, and in the background in relation to the proceedings at the Court of Appeal. On materially similar facts as were considered in these three appeals, some courts have decided against claimants in the face of submissions the reasoning of which now forms the ratio of the Court of Appeal's decision; the said ratio will now bind courts to decide cases differently. From a legal perspective at least, the judgment will provide welcome certainty.

The compensation due to consumers has been estimated to be as high as £42 billion – see: https://inews.co.uk/news/business/motorists-claim-billions-car-finance-commissions-payback-court-ruling-3345585

However, the court acknowledged at [176]-[178] some challenges in reconciling earlier decisions of the Court of Appeal. This may potentially lead to further litigation in the cases, or in future cases. Close Brothers has said that it will appeal (see the above linked article). It raises the prospect that the reasoning in *Wilson & Anor v Hurstanger Ltd [2007] EWCA Civ 299 4 All ER 1118* at [43] may be challenged before the Supreme Court: "*If you tell someone that something may happen, and it does, I do not think that the person you told can claim that what happened was a secret. The secret was out when he was told that it might happen."* The logic of this finding is assailable. There may also potentially be argument that the Disinterested Duty is merely a way of setting out a "rule" to be applied in broker/borrower cases to determine that a fiduciary duty exists.

The *Wrench* case was to my knowledge the first in which a court held (as the Court of Appeal has now determined, correctly) that a commission can remain secret where a commission clause appears in paperwork handed to the prospective borrower. It is not a question of contractual incorporation. In future cases the courts will need to look more closely at the circumstances to determine whether secrecy was negated. This has an effect on the availability of remedies, as outlined above. It is likely to mean that more borrowers are able to successfully argue for rescission/"unwinding" of their agreements.

In terms of the wider effects, the judgment will likely lead to a fundamental change in practice across the motor finance industry. For example, lenders and dealer broker companies in their roles as credit brokers, where they choose to pay/receive a commission, can be expected to give to borrowers full disclosure of all material facts.

Associated regulatory changes can be expected to follow.

The case can also be expected to have a similar effect in relation to credit broking more generally – with brokers doing more to ensure that prospective borrowers know about the payment of the commission, its amount, and all the material facts necessary to understand

the implications of that payment. Ultimately, for consumers this may have a positive impact on consumer lending, enabling consumers to make more informed choices and helping to ensure that they receive credit on the best possible terms.

Finally, I would like to acknowledge the huge amount of work that companies such as Consumer Rights Solicitors, and individuals such as Rodney Garder of Touch Business, have done in relation to claims such as these. Many similar cases have been brought before the courts in the past 18 months, and have been argued against by highly able defendant counsel. The judicial process teases out the applicable law, and shapes and refines the arguments across many cases, before they can be distilled and finally adjudicated upon at this level. Much has been learned from those arguing for and against such cases.

On a personal note, I would also like to acknowledge Mr Wrench's contribution – described in the judgment as a "*postman with a penchant for fast cars*." His character and resolve have been a source of conviction, and a reminder of the importance of the case.