

Connected lender liability: clarification from the Supreme Court

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The Background

Described in its Long Title as existing “for the protection of consumers” and, judicially, in *Southern Pacific v Walker*¹ as having been passed “to protect consumers of credit, an aim which accounts for its substantive content and conditions its judicial interpretation”,² the 1974 Consumer Credit Act has been the focus of considerable and, arguably unjustified, criticism.³ Despite this, its role remains central as financial products become ever more complex and consumerism more rampant, as recently acknowledged in *Rankine v American Express Services Europe Limited*,⁴ where H. H. Judge Simon Brown QC commented on the need for the legislation to “protect the individual unsophisticated in financial affairs in contracts with unscrupulous and sophisticated financial institutions”.⁵

A plethora of recent legislation has sought to underpin this overriding objective of consumer protection. In addition to the Consumer Credit Act 2006, an array of delegated legislation was introduced to give effect to wide-ranging EU provisions,⁶ and furthermore, consumer credit-related regulated activity must now comply with the FCA's Consumer Credit Sourcebook (or “CONC”) as from 1 April 2014, to coincide with the transfer of consumer credit regulation and supervision to the Financial Conduct Authority.

In considering specific legislative examples to test the welfarist credentials of the Act, a key example would be the connected lender liability-based s75, which states:

“(1) If the debtor under a debtor-creditor-supplier agreement falling within section 12(b) or (c) has, in relation to a transaction financed by the agreement, any claim against the supplier in respect of a misrepresentation or breach of contract, he shall have a like claim against the creditor, who, with the supplier, shall accordingly be jointly and severally liable to the debtor.”

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Southern Pacific Personal Loans Ltd v Walker [2009] EWCA Civ 1218; [2010] 1 All E.R. (Comm) 854; [2010] Bus. L.R. 418.

² *Southern Pacific Personal Loans Ltd* [2009] EWCA Civ 1218 at [23] per Mummery L.J.

³ e.g. *McGinn v Grangeworth Securities Ltd* [2002] EWCA Civ 522; *Times*, May 30, 2002; *Independent*, July 15, 2002 at [1] per Clarke L.J.

⁴ *Rankine v American Express Services Europe Limited* (2008) C.T.L.C. 195.

⁵ *Rankine* [2008] C.T.L.C. 195 at [9]. The *Report of the Committee on Consumer Credit* (Cmd.1971) 4596 (“*Crowther Committee Report*”), the catalyst for the Consumer Credit Act 1974, stated that the main objective of the legislation was “to provide for the small individual borrower the protection he unquestionably needs” (at [6.6.3]–[6.4]).

⁶ Most recently the Consumer Credit Directive 2008/48 on credit agreements for consumers and repealing Council Directive 87/102 [2008] OJ L133/66, effective for consumer credit agreements made on or after February 1, 2011.

This multifactorial provision firstly requires there to be a regulated “debtor-creditor-supplier agreement”. Such will exist where there is a business connection between the creditor and supplier or, more specifically, an agreement intended “to finance a transaction between the debtor and a person (the “supplier”) other than the creditor”⁷ and “made by the creditor under pre-existing arrangements...between himself and the supplier”⁸ where the cash price is over £100 but not £30,000.⁹ So, an example of a s.75 arrangement would be a typical credit card transaction, where the credit card company will have “arrangements” with a supplier (or retailer), whereby the latter agrees to accept the provider’s credit cards from customers as a mode of payment for the goods provided. Such tripartite relationships are known collectively as “three-party” debtor-creditor-supplier agreements,¹⁰ and also include loans provided to customers to facilitate purchases from the supplier, where arrangements exist between lenders and suppliers, under which the former provides finance to facilitate purchases from the latter. Clearly, this provision will not apply to s.12 (a) “two-party” debtor-creditor-supplier agreements such as hire purchase of conditional sale agreements, where the lender and supplier are the same entity.

Section 75 imposes joint and several liability on the supplier and creditor. As such, a party who obtains faulty and/or wrongly described goods for example, could, on the basis of s.75, claim against the credit card company or the supplier where the latter is in breach of contract, provided such a claim complies with the six-year rule under s.5 Limitation Act 1980, which states that an action in contract “shall not be brought after the expiration of six years from the date on which the cause of action accrued”. Such a contractual breach, may relate to express or implied terms- typically s.14 Sale of Goods Act 1979, and the requirement under s.14(2A) for goods to be of “satisfactory quality” or, more specifically, to “meet the standard that a reasonable person would regard as satisfactory, taking account of any...relevant circumstances”. Significantly, s.75(1) will also apply to transactions entered into abroad by customers of UK card issuers,¹¹ and those situations where only a deposit to the credit transaction is paid by credit card with the balance being settled with cash. Additionally, s.75 is relevant where a supplier has perpetrated a misrepresentation as to the nature of the goods or credit agreement, whereupon the customer, again, may pursue a claim against the supplier and a “like claim” against the creditor. However, what is meant by a “like claim”? It has generally been accepted that the customer is able to seek rescission against the supplier for that particular transaction whilst abstaining from making further payments to the creditor.

⁷ Consumer Credit Act 1974 s.11(1)(b).

⁸ Consumer Credit Act 1974 s.12(b).

⁹ The new s.75A, introduced as part of implementation of the Consumer Credit Directive 2008/48, confers protection for purchases of over £30,000 in certain prescribed circumstances.

¹⁰ From April 1, 2014, such are described as ‘borrower-lender-supplier agreements’ by virtue of the Regulated Activities Order (SI 2013/188).

¹¹ *Office of Fair Trading v Lloyds TSB Bank Plc* [2007] UKHL 48; [2008] 1 A.C. 316; [2007] 3 W.L.R. 733.

However, the area of substantive confusion has been whether (or not) s.75 also conferred a right to rescind the credit agreement as well as the supply agreement?

Judicial attempts to answer this question have until recently been rather unsatisfactory, thereby leading to considerable academic debate and conceptual ambiguity. For example, in *United Dominions Trust v Taylor*,¹² the debtor rescinded a contract of sale for a car with a supplier and claimed to have “a like claim against the creditor” bank in respect of the loan provided for its purchase. It was held that the words “a like claim” were wide enough to include a claim for rescission of the loan contract, even though the creditor had not been responsible for any misrepresentation and/or breach of contract, Sheriff Principal Reid opining that

“It would be odd, to say the least, if the right to rescind was not available against the creditor and the right to restitution, which depends of rescission, was available...The section does not require that the claim against the creditor shall be justiciable on like grounds to the claim against the supplier, merely that it shall be the same sort of claim. The words ‘a like claim’ are thus wide enough to include a claim for rescission although the creditor has given no grounds for rescission of the loan contract.”¹³

Despite this view being adopted in the later case of *Forward Trust Ltd v Hornsby*,¹⁴ there has been considerable critique of its “logic”¹⁵ and, indeed, such would seem to contradict the original intentions of the Crowther Committee, which anticipated a breach of s.75 rendering the creditor “answerable in damages...for breaches of any term of the agreement relating to title, fitness or quality of the goods” only.¹⁶

The Supreme Court

The matter would now appear to have been settled by the Supreme Court in *Durkin v DSG Retail Limited*,¹⁷ on appeal from the Scottish Inner House Court of Session¹⁸. In what is likely to become seen as a seminal authority on connected lender liability, the Supreme Court has circumvented the conceptual difficulties inherent in affording rescission of a s.12(b) credit agreement under s.75.

The facts of this case were that in December 1998, Mr Durkin entered into a s.12 (b) agreement for the purchase of a laptop computer from PC World. It was agreed that should the laptop not have a inbuilt modem, Mr Durkin could return the item to the

¹² *United Dominions Trust v Taylor* 1980 S.L.T. 18.

¹³ *United Dominions Trust* 1980 S.L.T. 18 at 30.

¹⁴ *Forward Trust Ltd v Hornsby* 1995 S.C.L.R. 574; [1996] C.C.L.R. 18.

¹⁵ e.g. Davidson, "The Missing Link Transaction" (1980) 96 L.Q.R. 343; and Lowe, "Missing Link Transactions—Further Observations" (1981) 97 L.Q.R. 532; *Guest and Lloyd, Encyclopaedia of Consumer Credit Law* (Sweet & Maxwell, 1999), p.2074/4.

¹⁶ *The Report of the Committee on Consumer Credit* (Cmnd.4596, 1971) at [6.6.26–27].

¹⁷ *Durkin v DSG Retail Ltd* [2014] UKSC 21; [2014] 1 W.L.R. 1148; [2014] 2 All E.R. 715.

¹⁸ *Durkin* [2010] CSIH 49; 2010 S.C. 662; 2011 S.L.T. 114.

store (the PC World policy was not to permit customers to remove a laptop from its box before purchase). Mr Durkin paid a £50 deposit, with the remaining balance of £1449 financed by a credit agreement with HFC. Within one day of purchase, and having identified that the laptop did not possess a modem for internet access, he attempted to return the laptop to the store and sought rescission of the sale *and* credit agreement.

The store manager refused to accept Mr Durkin's rejection of the laptop and failed to act to assist in the cancellation of the credit agreement which soon accumulated considerable arrears, with Mr Durkin having refused to make payments as they fell due. In addition to the arrears, HFC had registered numerous adverse entries on credit registers which had prevented the latter from obtaining low rate finance elsewhere. With this in mind, Mr Durkin issued an action for declaratory relief against DSG and HFC in the Aberdeen Sheriff Court which, in 2008, ruled that the sales contract had been validly rescinded ¹⁹ and, notably, that Mr Durkin had, under s75(1) been entitled to rescind the credit agreement, and awarded him damages of £8,000 for injury to his credit, £6,880 in extra interest incurred on the HFC debt and £101,794 for the loss of capital gain accruing from his inability to purchase a property abroad as result of his damaged credit file. Perhaps not unsurprisingly, HFC appealed on the court's interpretation of s.75 (1).

The Inner House ²⁰ (which reversed the earlier decision in respect of loss of interest and loss accruing from his being denied the opportunity to purchase property abroad) determined that s.75 did not permit rescission of a credit agreement, with Lord Mackay of Drumadoon opining that in the event of a breach of a supply contract

“... the statutory provision which is now section 75(1) (and the terms of the amendments to it that were debated) were intended to ensure that when a debtor has a claim against his supplier he shall have the like claim, in sense of a similar claim, against the creditor, who has lent funds to finance the contract of sale, not a different or distinct claim against that creditor...had Parliament intended that breach of the contract of sale should, of itself, entitle the consumer to rescind the credit agreement (or that rescission of the credit agreement would automatically occur if the contract of sale were rescinded), it would, in our view, have used different language than is to be found in section 75.”²¹

So it was clear: the supply and credit agreements were distinct, and “joint and several liability” would not extend to the rescission of the credit agreement, but only to enable the recovery of damages from a supplier (and from his creditor), to

¹⁹ PC World did not subsequently appeal on this point.

²⁰ *Durkin [2010] CSIH 49; 2010 S.C. 662; 2011 S.L.T. 114.*

²¹ *Durkin [2010] CSIH 49; 2010 S.C. 662; 2011 S.L.T. 114* at [56]–[59].

compensate him for loss that he has incurred, or is liable to incur, by reason of present and future obligations under the credit agreement to make payments.

However, the Supreme Court, whilst agreeing with some elements of Lord Mackay's approach,²² reversed this earlier decision and suggested that rescission of a credit agreement forming part of a s.12 (b) transaction was appropriate in certain circumstances, but by a different and less obvious route. Lord Hodge, in delivering the only judgment (with Lady Hale, Lords Wilson, Sumption and Reed agreeing) postulated that–

“It is inherent in a debtor-creditor-supplier agreement under s.12(b) of the 1974 Act, which is also tied into a specific supply transaction, that if the supply transaction which it financed is in effect brought to an end by the debtor's acceptance of the supplier's repudiatory breach of contract, the debtor must repay the borrowed funds which he recovers from the supplier. In my view, in order to reflect that reality, the law implies a term into such a credit agreement that it is conditional upon the survival of the supply agreement. The debtor on rejecting the goods and thereby rescinding the supply agreement for breach of contract may also rescind the credit agreement by invoking this condition.”²³

This clearly indicates a fundamental shift in interpretation: whilst the court acknowledged that the Inner House had been correct in its analysis of s.75 per se, and this provision would not offer rescission where such was not already available under the general law, it concluded that Mr Durkin could rescind the credit agreement based upon the common law implied term, where the supply agreement has already been rightfully rescinded for breach of contract, be this a breach of implied or express terms. Such a right to rescind a related credit agreement represents more than a nuanced amendment to established legal authority and goes well beyond the remedy of damages envisaged by the Crowther Committee Report²⁴ – albeit at a quantum to include losses incurred in complying with any credit agreement which, Lord Hodge confirmed, would not “extinguish his debt until either it was upheld by the court or the creditor agreed to cancel the debt”,²⁵ a position which would be generally unsatisfactory to the debtor. The reality would now appear to be that where there exists a s.12(b) agreement, rescission of the credit agreement is facilitated by common law principles and not s.75, although as Lord Hodge stated “the result is the same but the mechanism more simple”.²⁶ The practical consequences of this approach are that where a s.12(b) transaction is underpinned by a credit card purchase, the implication of such a term will not entitle the debtor to rescind the entire credit card agreement, only that part of the credit facility used to make the purchase. Of course, the position is different should the instrument

²² *Durkin* [2014] UKSC 21; [2014] 1 W.L.R. 1148; [2014] 2 All E.R. 715 at [19].

²³ *Durkin* [2014] UKSC 21; [2014] 1 W.L.R. 1148; [2014] 2 All E.R. 715 at [26].

²⁴ *The Report of the Committee on Consumer Credit (Cmnd.4596, 1971)* at [6.6.26–27].

²⁵ *Durkin* [2014] UKSC 21; [2014] 1 W.L.R. 1148; [2014] 2 All E.R. 715 at [22].

²⁶ *Durkin* [2014] UKSC 21; [2014] 1 W.L.R. 1148; [2014] 2 All E.R. 715 at [28].

financing the transaction be a loan, taken for the specific purchase, where such could clearly be rescinded in its entirety should circumstances permit. On a similarly pragmatic note, the Supreme Court further acknowledged²⁷ that HFC was under a duty of care in negligence to Mr Durkin to ensure the credit agreement had not been rescinded (as he claimed it had been) before reporting adverse credit to credit reference agencies. Their breach of this duty sounded in damages, assessed at £8,000. To this end, lenders should now take steps to investigate such matters to avoid claims from aggrieved debtors whose credit has been compromised and not indicate a default until such questions are resolved.

In essence, the connotation of this decision is that even where he has fully complied with the numerous and byzantine legislative consumer credit provisions, a creditor may not be able to avoid rescission and the inevitable uncertainty over the amount of interest he can ultimately claim from the debtor although, as the Crowther Committee suggested, it was paramount that the debtor be endowed with certain guaranteed contractual rights, particularly so where there was a connected lender and supplier “engaged in a joint venture to their mutual advantage”.²⁸ To this end, therefore, the Supreme Court has further shifted the balance of protection towards the consumer by circumventing the manifest precincts of s.75 through use of the traditional implied term, itself a simplistic yet highly effectual tool for reinforcing the *raison d'être* of the Consumer Credit Act, namely consumer protection. This will obviate the need to seek the sanction of other, less malleable common law principles, such as frustration which, according to Lord Hodge, would not assist a debtor “because the creditor will have paid the supplier and the purpose of the credit agreement will have been fulfilled by the purchase of the goods, before the consumer rescinds the supply contract”²⁹

²⁷ *Durkin* [2014] UKSC 21; [2014] 1 W.L.R. 1148; [2014] 2 All E.R. 715 at [33]–[34].

²⁸ *The Report of the Committee on Consumer Credit* (Cmnd.4596, 1971) at [6.2.24].

²⁹ *Durkin* [2014] UKSC 21; [2014] 1 W.L.R. 1148; [2014] 2 All E.R. 715 at [25], *Krell v Henry* [1903] 2 K.B. 740 distinguished.