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Commercial First Business Limited v Pickup & Vernon

(unrep, Ch Div, Manchester District Registry, 6th December 2016)

OVERVIEW

The matter of undisclosed commissions was back before the Courts in the latest judgment on this subject. The case of Commercial First Business v Barry Pickup involves a counter claim by the Defendant borrowers. It has provided further commentary on the question of fiduciary duties and the payments of secret commissions to secured loan credit brokers.

The Facts

The borrowers were experienced property investors. Via two specialist credit brokers; Select Finance and Active Mortgage Management, were introduced to Commercial First, a well-established commercial lender operating in the secondary lending market. During the period May 2007 to February 2008, the borrowers entered jointly into five loans with Commercial First totalling £1,032,714, plus a further secured loan to the second borrower for £63,750

Each of these loans attracted a commission payment to the respective credit broker:

1. Three of the loans paid a commission at 2% (£8,100, £1,275 and £2,294.28);
2. The fourth a commission of 4% (£8,400);
3. The fifth 2% (£2380);
4. The sixth 4% (£7,360)

Totalling in £29,809.28 worth of commission.

The borrowers had paid a broker's fee in relation to the first loan but had not paid one in respect of the second, third, or fourth loan.

By the time the borrowers entered into the last two loans Commercial First had acted upon the issues raised in the Hurstanger Judgment in 2007. Subsequently, these loans contained a warning that they were to pay the credit broker 2% and 4% of the loan amounts respectively. The earlier loans all contained a form of warning from the credit brokers that they were to be paid a commission from the lender, but did not confirm the precise amount they were to receive.

Following the 2008 credit crunch the borrowers got into difficulties with their loans, the result being that Law of Property Act receivers were appointed with the properties being sold at a forced sale value below their expected valuations. Due to this, by the time of trial Commercial First's claim against the first and second borrower was £1,342,577.79 and £1,267,944 respectively.

The counter claim by the borrowers requested the following forms of relief:

1. A claim for rescission of the agreements and damages in respect of undisclosed commission payments of loans 1-4;
2. That the relationship between them and Commercial First was unfair pursuant to the test set out in s.140 Consumer Credit Act 1974, and;
3. Reasonable steps were not taken to achieve a fair price when the properties were repossessed by Commercial First

For the purposes of this document, I will provide commentary on points 1 and 2 alone.

The Courts View

Secret Commission

The borrowers' evidence was that they were aware of the commission payments on the last two loans and "were happy to proceed regardless" and that it caused the second borrower "no concern" [37]. In terms of the earlier loans via Select Finance, whilst both borrowers affirmed that they were not aware of the commission payment, their evidence was that it "would have made no difference and the transactions would have proceeded regardless on the same terms".

Commercial First had already "credited the defendants with the amounts of commissions paid to Select Finance" prior to proceedings being commenced, therefore any claim for equitable compensation had already been settled (although without any obligation to do so). The residue of the borrowers' case was limited to (i) rescission of the relevant agreements, and; (ii) All losses flowing from entering into the agreements, premised on the payments of commission being a species of fraud whereby it is unnecessary to prove motive, inducement or loss up to the amount of the payment (Mahesan v Malaya's Housing Society [1979] AC374, 383). On that basis, the Court proceeded to assess whether Select Finance's relationship with the borrowers was a fiduciary one.
Mr Griggs, a former director of Select Finance, gave evidence that they were not a "whole of market" broker and operated within a selected panel of lenders. Further, it was stated that the service offered by Select was simply to provide a quotation to the potential borrower. However, Mr Griggs was unable to provide all the documentary evidence to support his assertion, this being shredded at the point the company was dissolved in 2013. One document was available though, the borrowers' quotation, which included a warning in a form labelled Our Mortgage Services, which stated that "a fee of £1500 is payable on completion. We will also be paid commission by the lender"; however, it was only the first loan via Select where a broker fee was paid.

The further three loans brokered by Select did not benefit from the Our Mortgage Services document. The Court inferred [46] that it was "more likely than not" that the subsequent loans would have been accompanied by this document. On that basis it was concluded that all four loans were half-secret cases.

Turning to the question of fiduciary duties, the Court paid regards to the classic test formulated by Millett LJ in Bristol and West Building Society v Mothew [19998] Ch1. Broadly speaking the test is as follows:

(a) The relationship is one of trust and confidence;
(b) There is an obligation of single minded loyalty;
(c) The agent must act in good faith;
(d) Must not make a profit out of the trust;
(e) Their duty and interest must not conflict;
(f) They must not act for their own benefit without the informed consent of the principal

In further support that the relationship between the borrowers and Select was a fiduciary one, they relied on the decision in Hurstanger and Nelmes v NRAM PLC [2016] EWCA Civ 491. However, on the basis of the facts of the case, the Court distinguished these authorities. Instead, preferring a body of first instance decisions, namely (i) Yates and Lorrenzelli v Nemo Personal Finance, (ii) Sealey and Winfield v Loans.co.uk and (iii) Buckingham v Blackhorse. As [52] the Court took the view that these were half-secret type claims, the borrowers could not have "reasonably expected undivided loyalty" and that therefore there was no fiduciary duty. Further, the lack of contract and brokerage fee paid between the borrowers and Select persuaded the Court on this point.
The conclusion by Judge Platts in Yates and Lorrenzelli v Nemo Personal finance [52] was also relied upon:

"In reality the evidence is limited to the fact that the claimant visited a broker in order to get a loan...There being no agency and no fiduciary relationship, it seems to me that the allegation

The Courts View

that the first defendant has procured a breach of fiduciary duty must fail."

Remedies

In case the analysis of the fiduciary point was wrong, the Court turned to the question of remedies. As I set out above, Commercial First had already repaid the commission amounts to the borrowers prior to trial, therefore equitable compensation, which the Court held at [55] would have been available as "a right" anyway had been dealt with.

In terms of any further equitable remedies, the Court was not persuaded. The Borrowers submitted that they would be entitled to rescission of the agreements. However, the Court found that as counter restitution could not be made, rescission was not available.

Lastly, did any further losses flow from the procurement of Select's breach of fiduciary duty? The answer was no. "This is not the case of the defendants entering into a transaction on terms disadvantageous to them as a result of the commissions". The borrowers' evidence that they had no complaints with the loans was central here.

Unfair Relationship

In order to assess whether relief is available via section 140B of The Consumer Credit Act 1974 ("The Act"), the Courts are required to determine whether the relationship between the creditor and debtor is 'unfair' for one or more of the following reasons:
(1) Any term of the agreement;
(2) The way in which the creditor has enforced the agreement;
(3) Anything else done (or not done) by or on behalf of the creditor

In doing so, the Court must "have regard to all matters it thinks relevant"

The borrowers' submissions were that:
a) The payment of a secret commission created a conflict of interest which "induced" them to enter into an unfavourable agreement;
b That Commercial First "closed its eyes to clear and obvious unsuitability of the mortgage offers it made" [74]. Namely that the borrowers would be aged 88 and 72 at the end of the term;
c) The rate of interest was excessive; at 8-10%;
d) The loan to value at 74% "created a portfolio of toxic loans"

The secret commission type claim (a & b above) essentially rested on whether or not the payment of a (half) secret commission by Commercial First have (i) induced Select to 'advise' the borrowers to enter into an agreement that was unfavourable to them, and/or; (ii) Commercial First "wilfully closed its eyes" to the unsuitability of the agreements key terms.

The Court's view was that the borrowers were experienced property investors. They knew exactly what they were doing and were ostensibly happy with the terms. Further, and in consideration of the irresponsible lending type argument, the agreements were to be serviced by rental incomes. On that basis their age at term was not relevant. Consequently, the Court found no unfairness in the relationship between the parties.

Analysis

This matter involved two experienced and arguably sophisticated investors. Commercial First were a specialist lender offering commercial loans to individuals and businesses. Therefore, even absent the borrowers' evidence at trial (which was not particularly helpful), could have been an inference of sophistication.

The Court's accepted evidence from Mr Griggs of Select Finance. The service his firm offered was merely to provide a quotation. Whilst this evidence does not appear to have been challenged by the borrowers' counsel, Mr Meacham, or their expert, the Court's readiness to accept this is quite remarkable. Secured lending is a highly complex matter, with commercial transactions being exponentially more so. Select were paid substantial brokerage fees. Whether the borrowers were 'experienced investors', or not, is irrelevant (opinion only), a fee of this level would carry with it the expectation that an element of value judgement, i.e. advice, would form part of the service. Furthermore, a secured credit broker, whether residential or commercial will pay a key part in the transaction. Their role encapsulated advice, packaging and a quasi-underwriting role that supported the creditor. Given the reliance on paragraph 52 of the Yates v Nemo judgment, further evidence on this critical point ought to have been adduced.

The body of appellate level decisions (Hurstanger, Nelmes and McWilliam v Norton) in relation to (half) secret commission payments all leans towards the view that the appropriate remedy is equitable compensation up to the amount of the commission paid. In this matter the commission was refunded prior to trial. In that regard at least, this judgment accords with the case law that preceded it.

The Court's view was that knowledge of a commission being paid should be sufficient to extinguish any expectation of loyalty [52]. I find this astonishing, particularly in circumstances where the level of commission paid was as high as it was in this case. Secondary lending, has a high propensity to go wrong. Borrowers entering this market have done so because primary vanilla type products are not available. The underwriting, products and policies were complex; they required an experienced professional to ensure the borrowers suitably navigate their way through them. Had the borrowers been on notice in relation to the level of commission, perhaps an expectation of loyalty could be discounted.

The question of rescission of the agreements where counter restitution has not been made (i.e. the loan capital at the very least has been repaid) is equally uncontroversial. Hurstanger makes very clear at 39 that counter restitution is a prerequisite, as is the matter being a fully secret one.

Turning to the Unfair Relationship claim, I broadly agree that a rate of 8-10% and a loan to value at 74% is not particularly startling, especially when viewed within the landscape borrowers found themselves in prior to the 2008 crunch. Nor was the borrowers age a real reason for concern. Buy to lets are, and always were, premised on the rental coverage, of which it appears Commercial First made a sound assessment.

Undisclosed commission claims begin firmly on the back foot where the debtor is suitably sophisticated, such as in the case of the borrowers. That said, the level of commissions paid in this case were significant and perhaps with expert evidence to demonstrate that Select's role was more substantial than submitted, a different result may have occurred.

What Next

The lack of broker fee, the sophistication of the borrowers and the evidence at trial suggest that this case has minimal significance to this claim sector. The rhetoric contained within the judgment suggests that had Commercial First not refunded the commission payments, then it would have ordered them to do so. In half-secret type cases one would ordinarily expect for this remedy to be ordered.

The majority of active cases being processed through the system at present are readily distinguishable from the facts of this case. Most matters concern retail borrowers with a variety of characteristics that demonstrate vulnerability or a lack of sophistication. For example, those entering the second charge residential market with substantial arrears or adverse credit. The demographic of these borrowers is markedly different.

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