Feature

KEY POINTS

- The sale of payment protection insurance policies in connection with unsecured loans has proved a controversial area in which borrowers have historically fared badly.
- Claims management companies have entered the field with a variety of standard arguments with which to challenge enforceability or to claim alternative relief.
- The recent case of *Black Horse Ltd v Speak* exposes the limits of those arguments if the lender's representative has properly followed well-designed procedures.

Author Elizabeth Ovey

Loans and payment protection insurance: an optional policy win for the Black Horse

Although payment protection insurance policies have been frequently mis-sold, recent court decisions suggest that some borrowers are now challenging agreements involving such policies in cases where the lender has complied with the relevant regulatory requirements. Elizabeth Ovey analyses the limits of claimants' standard arguments in such circumstances.

THE BACKGROUND

The past five years have been difficult ones for lenders who also sell payment protection insurance ('PPI').

On 4 November 2005, the Financial Services Authority ('FSA') issued a press release stating that it had 'today called on firms to take urgent action to ensure that their selling practices for PPI are in line with regulatory requirements'.

By September 2007, in its thematic update on the sale of PPI, the FSA was still complaining of substantial shortcomings by firms.

On 23 February 2009 the FSA wrote to all firms selling single premium PPI policies in connection with unsecured personal loans requesting them to stop doing so as soon as possible and in any event by 29 May 2009.

Finally, in Policy Statement 10/12, published in August 2010, the FSA set out proposed amendments to the dispute resolution provisions in the *FSA Handbook* intended to secure fair handling of complaints about sales of PPI products. Those amendments were regarded by the British Bankers' Association as involving the retrospective imposition of new standards on old sales, and it began proceedings for judicial review of the policy statement on 8 October 2010. In a statement made on 24 November 2010, the FSA made it clear that it is defending those proceedings.

Not surprisingly, these developments have attracted considerable publicity, and, also not surprisingly, claims management companies have been to the fore with offers of assistance in bringing PPI misselling claims, usually by taking the claims to the Financial Ombudsman Service ('FOS'). In the year to 31 March 2009, 62 per cent of the complaints about insurance received by FOS related to PPI, representing an increase over two years from 1,832 in the year ending 31 March 2007 to 31,066 in the year ending 31 March 2009, and in over half of the cases the complainant was represented by a claims management company. Most of the complaints related to single premium policies, and in 2008-2009 89 per cent of PPI complaints were successful.

There is thus plenty of material to support the view that PPI was frequently missold and that consumers may have legitimate complaints. Recent court decisions, however, suggest that some claims are now being brought in cases where the lender has complied with the relevant regulatory requirements and the basis of the claim is less obviously meritorious. Often these cases are heard in the county court, but a rare High Court example is the decision of His Honour Judge Waksman QC in *Black Horse Limited v Speak* [2010] EWHC 1866 (QB).

BLACK HORSE V SPEAK

The facts were short and simple. On 13 October 2006 Mr and Mrs Speak entered into a regulated consumer credit agreement with Black Horse Limited ('the Bank'), a subsidiary of Lloyds TSB, by which they received the sum of £5,000 repayable over 62 months. On the same day they took out a single premium PPI policy with another Lloyds TSB company, the premium of £2,102.39 being financed by the Bank and being repayable over the same 62 months at the same rate of interest as the loan. Mr and Mrs Speak fell into arrears and the Bank brought proceedings for payment of £7,179.66 and costs.

Mr and Mrs Speak defended the claim on four grounds, all of which will be familiar to litigators in this area:

- they were required to take out a PPI policy offered by the Bank as a condition of obtaining the loan. Therefore the policy premium should have been shown as part of the total charge for credit, and not as part of the amount of credit, meaning that one of the prescribed terms was misstated and the agreement was irredeemably unenforceable by virtue of s 127(3) of the Consumer Credit Act 1974;
- alternatively, if the PPI policy was not required, the Bank's employee, Ms O'Halloran, misrepresented that it was and the Bank was liable in damages;
- the Bank was in breach of statutory duty through failing to comply with certain FSA rules relating to the conduct of insurance business, again giving rise to a right to damages;
- by reason of the Bank's conduct in respect of the sale of the policy, an unfair relationship arose between the Bank and Mr and Mrs Speak for the purposes of s 140A of the Consumer Credit Act, making the powers given by s 140B exercisable.

The judgment makes clear that it was originally intended that the case should be one of three which might enable Waksman J to give general guidance to assist the courts in dealing with what he described as 'the very many' PPI cases proceeding in the county court. In the event, the other two cases settled. Mr and Mrs Speak themselves lost on all four grounds, principally because Waksman J found that Ms O'Halloran's account of the relevant meeting was to be preferred to that of Mr Speak. He therefore found as a fact that:

- Ms O'Halloran did not in any sense require Mr and Mrs Speak to take out a PPI policy as a condition of granting the loan;
- Ms O'Halloran went through a demands and needs questionnaire with Mr Speak in respect of both him and his wife and correctly recorded his answers;
- Ms O'Halloran told Mrs Speak what the questionnaire was and that PPI was recommended and selected;
- Mrs Speak had previously given her husband full authority to discuss the proposed loan with the Bank, answer any questions and agree terms. Ms O'Halloran sought confirmation of that at the meeting and was given it.

Although, as explained below, those findings were effectively fatal to Mr and Mrs Speak's case, the judge went on to express his views on a number of legal issues, no doubt having in mind the original intention of giving general guidance.

Before considering those issues, however, I draw attention to one interesting feature of the judge's decision on the facts. As will very often be the case in such situations, Mr Speak was giving evidence on the basis of his specific recollection of an individual transaction. Ms O'Halloran was giving evidence by reference to her usual practice; she did one such transaction or more each day. She also laboured under the potential disadvantages that there was some incentive for her to sell a PPI policy if she could, because it was one element in her monthly targets, and that the Bank's training materials said that staff should try to overcome objections by a customer to taking out a PPI policy if they could. Nevertheless, Waksman J found her a 'clear and reliable witness who gave her evidence candidly and carefully' and accepted her account of what had taken place.

Irredeemably unenforceable?

It is a very common feature of consumer credit litigation to find an assertion that there is a breach of the statutory requirements relating to the form and content of a regulated agreement. That is because under s 127(3) of the Act, an agreement is incapable of enforcement unless there is an agreement signed by the debtor containing the 'prescribed terms'. Section 127(3) was repealed with effect from 6 April 2007, but there are still in existence many regulated agreements which were entered into before that date. If there is no signed agreement containing the prescribed terms, correctly stated, the creditor cannot enforce payment through the courts.

In *Black Horse v Speak*, the relevant prescribed term was a term stating the amount of credit, specified as a prescribed term by para 2 of Sch 6 to the Consumer Credit (Agreements) Regulations 1983, SI 1983/1553. Mr and Mrs Speak's agreement was set out to show financial information relating to the personal loan and financial information relating to the PPI premium separately, stating an amount of credit, duration, total amount payable, monthly payment, annual percentage rate and total charge for credit for each. The premium was thus clearly stated to be part of the amount of credit and not part of the total charge for credit.

Mr and Mr Speak's argument was that under reg 4 of the Consumer Credit (Total Charge for Credit) Regulations 1980, SI 1980/51, as amended with effect from 14 April 2000, the premium under a compulsory PPI policy formed part of the total charge for credit. (Regulation 4 does not cover the premium under an optional policy because the essence of a charge for credit is that it is part of the 'price for the loan, whereas the premium on an optional policy is the principal sum required to purchase an add-on extra.) Further, under s 9(4) of the Act itself, an item entering into the total charge for credit may not be treated as credit even if time is allowed for payment. If, therefore, but only if, the PPI policy was compulsory, the amount of the premium had wrongly been included in the amount of credit and the agreement was irredeemably unenforceable.

This argument necessarily failed in view of the judge's finding of fact that Ms O'Halloran did not in any sense require Mr and Mrs Speak to take out a PPI policy. He went on, however, to consider three further arguments which had been advanced by the Bank during the hearing.

(1) The Bank contended that even if Ms O'Halloran *had* told Mr and Mrs Speak that PPI was required, reg 4 would not have been satisfied because the Bank did not 'objectively' require PPI, as was made plain on the face of the agreement. In other words, if the Bank's policy, as shown by the written agreement, was that PPI was optional, it remained optional even if the Bank representative with whom the customer was dealing said that it was compulsory.
Not surprisingly, Judge Waksman had no difficulty in rejecting that argument. Regulation 4 applies if the policy 'is required by the creditor'. The effect is that one must look at the creditor's conduct: ie, the conduct of the representative of the creditor with whom the customer is dealing. If that representative insists on a PPI policy, it is required in the particular case, whatever may be the creditor's general policy. If Ms O'Halloran had chosen to ignore the Bank's policy and the procedure laid down in the training materials, that would have been fatal to the Bank's case.

(2) The Bank also contended that since Mr and Mrs Speak were entitled to cancel the PPI policy within 30 days of taking it out, reg 4 would not have been satisfied even if Ms. O'Halloran had required them to take such a policy out. Again Judge Waksman had little difficulty with the argument. Regulation 4 is directed to what is required at the time the contract is entered into, not at what may transpire subsequently. Moreover, reg 4 applies where *either* 'the making or maintenance'

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of the policy is required. While the existence of the right of cancellation might mean that the policy did not afford effective protection, that was not what reg 4 was dealing with.

In that respect, the judge's view differed from the view of His Honour Judge Ibbotson in the unreported case of *Beardsley v HSBC Bank plc* (Huddersfield County Court, 20 November 2008). Like Waksman J, Ibbotson J rejected an unenforceability claim on the ground that he was not satisfied that the bank's representative had said that PPI was compulsory. He went on to say that if there was an option to cancel without paying anything, the amount which would otherwise have been payable could not be said to be a charge for credit.

Waksman J rejected that view both because of his view of the construction of reg 4, as explained above, and because it was not clear to him that Ibbotson J had been addressing specifically the words of reg 4.

(3) A yet further argument run by the Bank was that even if Ms O'Halloran had required Mr and Mrs Speak to take out a PPI policy, so that the amount of the premium should have been stated as part of the total charge for credit, it could nevertheless properly be stated as an amount of credit (that is to say, there was no breach of s 9(4) of the Act) because the amount of credit had been split between the credit represented by the loan itself and the credit represented by the premium for the policy. There was thus no misstatement of the amount of credit which constituted the loan.

The judge described this argument as having a 'superficial attractiveness', because in fact all the individual features of the agreement were clearly set out and the borrower knew exactly what was being borrowed and what was being charged for it. Nevertheless, he did not accept the argument. He pointed out that it had not been suggested that the agreement was a multiple agreement. There was therefore factually credit of £7,012.39 (£5,000 and £2,012.39), but s 9(4) required the £2,012.39 to be excluded from the amount of credit altogether. As that had not been done, the amount of credit was misstated on the hypothesis the judge was considering (although in fact the judge found no breach of s 9(4) of the Act because, as explained above, the PPI policy was not found to be compulsory).

It is significant that it was not suggested that the agreement was a multiple agreement. It has been argued in some quarters that the agreement was indeed a multiple agreement for the purposes of s 18 of the Act, consisting of a debtor-creditor agreement for the amount of the loan and a debtor-creditor-supplier agreement for the amount of the PPI premium. The difficulty with that argument is that it seems to start with the assumption that there are two tranches of credit, one for the loan and one for the premium. That is no doubt a correct starting point if the PPI policy is optional. The judge, however, was proceeding on the hypothesis that the PPI policy was compulsory *and* that the amount of the premium was therefore part of the total charge for credit and required to be stated as such. The application of s 9(4) then seems to lead inescapably to the conclusion that for the purposes of the Act the only amount of credit under the agreement is the amount of the loan. If that is so, it is difficult to see how there could be a multiple agreement, the existence of which depends upon there being two tranches of credit.

Misrepresentation

Again, on Waksman J's findings of fact, there was no misrepresentation by Ms O'Halloran. To show misrepresentation would require the strange combination of a finding that Ms O'Halloran represented that PPI cover was compulsory with a finding that nevertheless the Bank was able to establish that in fact it was optional. The latter finding would be inconsistent with the views expressed by the judge on the additional arguments (1) and (2) considered above. There are thus very considerable difficulties in establishing that a misrepresentation was made at all in such circumstances.

Breach of statutory duty (ICOB rules)

The rules relied on were ICOB 2.2.3(1), which requires a firm to take reasonable steps to communicate in a way which is clear, fair and not misleading, and ICOB 4.3.1, which requires a firm to take reasonable steps to ensure that if a recommendation to buy is made, the recommendation is suitable for the customer's demands and needs.

Yet again, Mr and Mrs Speak failed on the facts, since Ms O'Halloran had made clear that PPI was optional. There was a particular point relating to Mrs Speak, since it was accepted that Ms O'Halloran had not gone through the demands and needs questionnaire separately with her, but had relied on Mr Speak's answers. It was argued that that was not sufficient. In the factual situation before him, Waksman J did not accept that argument, there being no allegation of undue influence or misrepresentation by Mr Speak to his wife.

There was, however, a cautionary note. The judge did not accept a general argument by the Bank that the duty to take reasonable steps would be discharged by giving proper training, even if a member of staff then acted contrary to what was required by the training.

Unfair relationship

This claim was made only if the agreement was found to be enforceable but there was also found to have been a misrepresentation or a breach of the ICOB rules. It therefore necessarily failed.

CONCLUSION

Although the Bank failed on certain of its arguments, rightly, it is suggested, there is comfort for lenders. The case shows that a lender which has developed proper procedures and which employs staff who adhere to those procedures may well be able to defeat the claim of a disenchanted borrower employing the standard arguments considered above. ■