Feature

KEY POINTS

- Unfairness requires a significant discrepancy between the market rate at the time for comparable products and the defendant's rate. The court may import Lord Sumption's notion of a "tipping point".
- In addition, the defendant must somehow have taken advantage of the claimant in imposing that rate. In *Plevin*, it was the non-disclosure which represented the "taking advantage" of the consumer.
- If the court is willing to use the "unfair relationship" provisions to rewrite the bargain notwithstanding the disclosure of the finance charge upon inception, this will represent a step beyond the *ratio* of *Plevin*.
- *Smith* keeps the shared appreciation mortgages (SAMs) claimants within primary limitation, but they must still justify their delay.

Authors Benjamin Pilling KC and Ruth Bala

Shared appreciation mortgages: how far can the "unfair relationships" regime stretch?

A trial of alleged mis-selling of shared appreciation mortgages (SAMs) by Bank of Scotland plc (BoS) is listed for early 2024. In this article Benjamin Pilling KC and Ruth Bala of 4 Pump Court review the issues in the case. Does the "excessive" finance charge generate an "unfair relationship"? Will the court be willing to use the "unfair relationship" provisions to rewrite a mortgage, where there was full disclosure upon inception of the level of the finance charge (c.f. PPI, where the high level of commission was undisclosed)? The authors also consider limitation.

WHAT ARE SAMs?

Shared appreciation mortgages (SAMs) were sold between 1996-1998. They were only sold by two banks: Barclays and Bank of Scotland (BoS). The defendant mortgagee in the forthcoming trial is a subsidiary of BoS: BoS (Shared Appreciation Mortgages) No 6 plc; BoS was the debt servicer.

Under a typical SAM the mortgagor did not pay conventional interest; instead the finance charge was calculated as up to 75% of the appreciation in the value of the mortgagor's home during the mortgage term. The mortgagee's profit share was usually calculated on a 3-2-1 basis: where the loan-to-value (LTV) was 25%, its finance charge would be 75% of the equity appreciation. There would typically be no repayments during the term: the term expired upon the mortgagor's death or sale of the property, and the mortgagee's equity share fell due at that stage. Most SAMs mortgagors were at or nearing retirement age at inception.

The property market soared in the years after the SAMs were sold, with the result that in some cases the mortgagee's share of the value of the property seemed startlingly high. One claimant in the current litigation took out a circa £187,000 mortgage in 1998 secured against a London home then valued at circa £750,000; the current property value is alleged to be £2.8m, so that the bank's share of the equity is £1.5m.

Commonly customers who took out SAMs never anticipated selling their homes, but for some customers unexpected circumstances forced them into a position where they needed to move, crystallising the bank's entitlement to a share of the equity.

Of course, the mortgagee would point out that movements in the housing market represented a risk for both parties. The market could have remained static or even fallen, and over the life of a long mortgage periods of growth would likely be balanced by periods of stagnation.

APPLICABILITY OF "UNFAIR RELATIONSHIPS"

The "unfair relationship" provisions in ss 140A-B of the Consumer Credit Act 1974 (CCA) do apply to SAMs, although the analysis is complicated.

The "unfair relationship" provisions are not confined to "regulated credit agreements"; they apply to the wider category of "credit agreements" with individuals (CCA ss 140A(1) and (5) and 140C(1)). There is one exception: pursuant to CCA s 140A(5), an order shall not be made under s 140B in respect of an agreement that is exempt from being a regulated credit agreement by virtue of Art 60C(2) of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO). This is the exemption for regulated mortgage contracts.

Mortgages predating the commencement of regulation by the Financial Services Authority (as it then was) in October 2004 are often known as "legacy mortgages". They were not regulated mortgages when entered and neither were they regulated credit agreements (the amount of credit exceeded the £25,000 cap on consumer credit regulation that applied at the time). It follows that legacy mortgages are not "consumer credit back book mortgages" (CCBBMs).

The "regulated mortgage contract" exemption from being a regulated credit agreement in RAO Art 60C(2)(c) provides that a credit agreement is exempt if by administering it on 21 March 2016, a person is carrying on an Art 61(2) activity. However, RAO Art 61(2)(b) provides that administering is only a specified activity in respect of legacy mortgages that were CCA regulated when entered (ie CCBBMs). This reflects the

Biog box
Benjamin Pilling KC has an international commercial practice and is listed in the directories as a leading silk in six fields, including Banking and Finance.
Email: bpilling@4pumpcourt.com

fact that legacy mortgages which are not CCBBMs do not fall within the current definition of a "regulated mortgage contract" in RAO Art 61(3)(a).

For these reasons, the CCA "unfair relationship" provisions are applicable to the SAMs.

WHETHER "EXCESSIVE" FINANCE CHARGE GENERATES "UNFAIR RELATIONSHIP"

One of the statutory gateways to unfairness is "any of the terms of the agreement" (s 140A(1)(a)) and this will include the term providing for the level of the finance charge. It is unlikely to be suggested that there is anything intrinsically wrong in the concept of a finance charge tied to any appreciation in the value of the security over the mortgage term. Instead, the claimants will say that the finance charge was "excessive".

Where a debtor alleges that the credit relationship is unfair due to the level of the interest rate, the market rate at the time for comparable products is a relevant factor (*Kerrigan & 11 ors v Elevate Credit International Limited (t/a Sunny) (in administration)* [2020] EWHC 2169 (Comm); [2020] C.T.L.C. 161, at [198(ii)]). Other "unfair relationship" interest rate cases where comparisons with the market rate have been made are *Greenlands Trading Ltd v Girolama Pontearso* [2019] EWHC 278 (Ch) (where the trial judge had found that the default interest rate under a bridging loan followed the industry standard) and *Pilgrim Rock Ltd v Iwaniuk* [2019] EWHC 203 (Ch) (where the trial judge had found that quarterly compounding of interest was "out of the ordinary in the market").

It will be difficult for the SAMs claimants to identify an appropriate comparator, as SAMs were an idiosyncratic product. The claimants will need to translate the SAMs' finance charge into a conventional interest rate, and that is likely to require the court to stand in the shoes of the parties at inception, and consider what assumptions might reasonably have been made about future movements in the housing market. The appropriate comparator rate will also be fact sensitive, depending on the individual claimant's credit history and financial circumstances.

Once a comparator is identified, it is suggested that there would likely need to be a significant discrepancy between its terms and the defendant's rate to generate an "unfair relationship". The role of the court under ss 140A-B should not be to rewrite the bargain so as to bring the defendant's product into line with its competitors, but to intervene where the level of the interest rate is egregious. It is conceivable that the court will import Lord Sumption's notion of a "tipping point" from *Plevin v Paragon Personal Finance Limited* [2014] UKSC 61; [2014] 1 W.L.R. 4222 (there in the context of the level of commission, rather than the level of interest rate).

An additional complexity in the SAMs litigation is the uncertainty of the bargain which the parties struck. The amount of the finance charge was not known upon inception, because it was dependent on fluctuations in the residential property market. The claimants are only able to complain that the finance charge was excessive because of the behaviour of that market during the term of their mortgages. The claimants are likely to say that there should have been a "cap" on the share of the appreciation, to rein in this uncertainty.

Supposing that the trial judge does find that, notwithstanding the uncertainty of the bargain, the SAMs' finance charge was grossly out of kilter with the market rate, it will not necessarily follow that there is an "unfair relationship". For instance, a party may choose to agree a high interest rate in order to obtain quick access to funds which it wishes to invest for profit. In addition to the rate discrepancy, it is suggested that the defendant must in some way have taken advantage of the claimant in imposing that rate. This will be a fact-sensitive inquiry and may depend in part on the sophistication of the mortgagor, including whether he/she was legally represented.

In the "payday loans" case of *Kerrigan*, HHJ Worster, sitting as a High Court judge, considered that whether the high interest rates generated unfairness would depend upon the characteristics of individual debtors. In particular, he relied on the concept of "marginal eligibility", which the FCA had used in its consultation paper. Debtors who were "marginally eligible" for the loans had a good basis for a claim that the high interest rate gave rise to an "unfair relationship" (at [212]). Where the debtor was "marginally eligible", the level of the interest rate was of particular significance to fairness, because there was greater potential for him/her to suffer harm (at [197] and [198(iv)]).

Another factor considered to be relevant in *Kerrigan* was the presentation of the interest rate upon inception and the debtor's awareness of it (at [198(iii)]).

In *Kumar v LSC Finance Ltd* [2023] EWHC 1439 (Ch) HHJ Rawlings, sitting as a High Court judge, said (at [229]):

> "I take the following factors, from the authorities, to be relevant in deciding whether the relationship is unfair because of the interest rate charged …
> (a) is the interest rate charged clear on the face of the loan documents;
> (b) did the debtor obtain legal advice before entering into the loan agreement;
> (c) the sophistication of the debtor and in particular whether they should be taken to understand the terms relating to interest contained in the loan agreement;
> (d) was the rate of interest so high that it was unfair, even if the debtor was aware of and understood its terms; and
> (e) the court may look at the market rate for similar loans."

In finding that the level of default interest rate was not "unfair", HHJ Rawlings pointed to the borrowers being represented by solicitors and signing an Offer Letter which clearly stated the default rate (at [240] and [244(b)]).

Both *Kerrigan* and *Kumar* underscore the importance of the clarity of the mortgage documentation and whether the borrowers were legally represented.

Biog box
Ruth Bala recently joined the Financial Services team at 4 Pump Court. She is ranked by Chambers & Partners in Band 1 for Consumer Finance and by Legal 500 in Tier 2 for Banking & Finance and Financial Services. She was shortlisted by Legal 500 for "Financial Services and Insurance Junior of the Year" 2022.
Email: rbala@4pumpcourt.com

DISTINCTION FROM PPI

Above, we have proposed a two-stage test in determining whether the SAMs' finance charge generates unfairness:

(i) was there a significant discrepancy between the SAMs' finance charge and the "market rate" for this claimant? and
(ii) if so, did BoS somehow take advantage of the claimant in imposing that rate?

In relation to (i), we have suggested that the court might invoke the *Plevin* concept of a "tipping point". However, at limb (ii) the *Plevin* analogy is unlikely to assist the SAMs claimants. *Plevin* is not authority that an egregious level of commission of itself generates unfairness; rather it is the excessive level in conjunction with the non-disclosure. As Lord Sumption said at [18]:

> "A sufficiently extreme inequality of knowledge and understanding is a classic source of unfairness … at some point commissions may become so large that the relationship cannot be regarded as fair if the customer is kept in ignorance. … The information was of critical relevance. … The fact that she was left in ignorance in my opinion made the relationship unfair."

It was the non-disclosure of the amount of PPI commission which represented the "taking advantage" of the consumer by the banks. That element does not feature in the SAMs sales, because there was full disclosure upon inception of the level of the finance charge.

As Lady Hale said in *OFT v Abbey National plc* [2009] 3 W.L.R. 1215 (at [93]):

> "As a very general proposition, consumer law in this country aims to give the consumer an informed choice rather than to protect the consumer from making an unwise choice."

If the court is willing to use the "unfair relationship" provisions to rewrite the bargain notwithstanding the disclosure of the finance charge, this will represent a step beyond the *ratio* of *Plevin*.

TRAPPED IN HOMES

The mortgagors will also allege that unfairness arises from being "trapped" in their homes, unable to move. Using a hypothetical example: a claimant took out a £75,000 mortgage in 1998 secured against a home then valued at circa £300,000 (25% LTV); the current property value is alleged to be £1m. If the claimant needed to move, then on the terms of the mortgage they would sacrifice £525,000 of equity, being 75% of the appreciation in value and more than half the value of the property. Without taking into account stamp duty and estate agents' fees, this would leave them with net sale proceeds of £475,000 to finance a new home. They may be forced to downsize to a flat, where this was not envisaged for their retirement.

On the other hand, BoS would point to the fact that its initial mortgage enabled the claimant to obtain an equity increase of £175,000 (25% of the appreciation in value). The claimant could not have achieved this without the assistance of a mortgage. Again, the issue will be the fairness of the finance charge relative to the market rate, taking into account the presentation of the charge, the characteristics of the borrower and their access to legal advice.

LIMITATION

It is presumed that the SAMs claimants will be current SAMs mortgagors, such that the SAMs finance charge will not yet have fallen due. On that presumption, these are not claims for reimbursement of the finance charge, but for declaratory relief, namely that the term of the credit agreement imposing the finance charge should be declared unfair and rewritten, eg so as to impose a cap on the amount of the finance charge.

Since the SAMs claimants do not seek reimbursement of sums paid, their cause of action will be an action on a specialty, subject to the 12-year primary imitation period in sub-s 8(1) of the Limitation Act 1980 (*Rahman v Sterling Credit Ltd* [2001] 1 W.L.R. 496). Moreover, primary limitation in respect of an "unfair relationship" claim does not start to run until the credit relationship ends (*Smith v Royal Bank of Scotland plc* [2023] UKSC 34). *Smith* puts paid to any contention by the mortgagee that primary limitation started to run at the date of the alleged unfairness, ie here when the finance charge was agreed, upon inception. In this litigation, primary limitation will not even have started to run, because the SAMs mortgages remain live.

Nevertheless, the claimants' delay in bringing proceedings may be relevant to the issues of:

(i) whether there is an "unfair relationship" under s 140A; and/or
(ii) whether the court should exercise its discretion to grant relief under s 140B.

In *Smith* at [54]-[57], Lord Leggatt considered a hypothetical situation where a claimant issued proceedings following the expiry of a 25-year term mortgage, seeking relief in respect of an excessive interest rate which had only been imposed for the first year of the mortgage. He commented that, in the absence of some extraordinary explanation, inaction by the debtor over such a long period would be an overwhelming factor pointing to the absence of unfairness under s 140A; alternatively, the court could refuse to make a s 140B order. In a concurring judgment, Lord Hodge stated at [89] that if a debtor sits on his hands in the knowledge of relevant facts, it would be inconceivable that a s 140B order would be just.

Accordingly, even though *Smith* assists the SAMs claimants by establishing that primary limitation has not expired (or even started to run), they must still satisfy the court as to the reasons for their delay in bringing this claim. This may prove challenging where they were legally represented upon inception. ■

Further Reading:

- Case Analysis (2023) 11 JIBFL 794.
- Plevin bound/unbound (2016) 4 JIBFL 220.
- Lexis+® UK: Financial Services: Consumer Rights Act 2015 – unfair terms.