Practical Law™

GOUGH SQUARE CHAMBERS' CONSUMER CREDIT COLUMN: OCTOBER 2015

This document is published by Practical Law and can be found at: uk.practicallaw.com/**9-619-3432**
Request a free trial and demonstration at: **uk.practicallaw.com/about/freetrial**

RESOURCE INFORMATION

RESOURCE ID

9-619-3432

RESOURCE TYPE

Article

PUBLISHED DATE

9 October 2015

JURISDICTION

United Kingdom

James Ross, Ruth Bala, Thomas Samuels and Lee Finch are all specialist consumer credit counsel at Gough Square Chambers. On a regular basis, they will share their views with Practical Law Financial Services subscribers on topical developments or key issues relating to consumer credit.

In the October column, Ruth Bala considers the meaning of credit.

Ruth Bala, Gough Square Chambers

THE MEANING OF CREDIT

The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (*SI 2001/544*) (RAO) draws a basic distinction between "regulated credit agreements" and "regulated mortgage contracts". Nonetheless, both types of agreements share something in common – they are contracts under which the lender provides "credit" (article 61 of the RAO and section 8 of the Consumer Credit Act 1974 (CCA)). It is therefore essential to understand the concept of credit before one can understand the scope of regulation of both credit agreements and mortgage contracts.

Statutory definition of credit

There is a definition of sorts in section 9 of the CCA (replicated in articles 60L and 61(3)(c) of the RAO). This provides that credit includes:

> "A cash loan, and any other form of financial accommodation".

Since the inclusion of a cash loan is somewhat obvious, and is itself said to be a subset of financial accommodation, after looking at section 9 one finds that the attempt to define credit is merely replaced by an attempt to define financial accommodation.

It is doubtful whether section 9 actually assists, particularly as not all financial accommodation would in fact be credit. "Accommodation" is commonly understood to mean a convenient arrangement – a compromise agreement to resolve a dispute, or a bargained trade discount could each be described as financial accommodation, yet neither would involve the granting of credit.

Deferment of payment

A much more useful definition of credit is given in Goode: Consumer Credit Law and Practice (volume 1, para 443 (cited by the House of Lords in *Dimond v Lovell [2002] 1 AC 384, at p394*)):

> "Credit [is] extended whenever the contract provides for the debtor to pay, or gives him the option to pay, later than the time at which payment would otherwise have been earned under the express or implied terms of the contract."

This test can be further distilled as follows: credit will be provided if the debtor is granted the **contractual right to defer payment** of a debt. In a straightforward cash loan, the time for repayment would "otherwise" be earned

Reproduced from Practical Law Financial Services with the permission of the publishers. For further information visit practicallaw.com or call 0207 542 6664. Copyright © 2015 Thomson Reuters (Professional) UK Limited. All Rights Reserved.

upon the making of the advance, but the terms of the credit agreement permit repayment in instalments over the minimum term.

The first point to note is that there must be a **contractual right** to defer payment. Credit is not provided where there is merely an outstanding obligation to make payment which the supplier agrees not to pursue. For this reason, it was held in *Manito v Elliot [2000] C.L.Y. 2593* that a contract for storage where the storage company was prepared to allow time for payment pending the outcome of litigation involving a customer did not involve credit. The position may well have been different if the customer had given consideration for the company's consent to his delay.

Deferment is relatively easy to identify when the arrangement involves the transfer of property, whether in the form of cash or goods. Payment would otherwise impliedly be "earned" when property and possession passes to the customer (usually when the customer receives the cash or goods). If the contract expressly permits repayment to occur a significant period after the transfer of the cash or goods, then there is likely to be credit.

Of course, there need not be any transfer of property – services may equally be supplied on credit. A company may earn the right to payment for its services as soon as they are supplied, but permit payment to be deferred by way of credit. In the context of the supply of services, the question of whether there is deferment can be more tricky.

One must resist the temptation of labelling an arrangement as credit simply because it involves the customer making periodic payments for services. The need for a "deferment" means that the right to payment must be "earned" earlier than the contractual time for repayment. In the context of the supply of services, the time when payment would otherwise be "earned" is generally the time when performance is "complete".

Severable and entire contracts

Difficulties in pinpointing the time of completion arise where services are supplied on an ongoing basis. In *Office of Fair Trading v Ashbourne Management Services Ltd [2011] EWHC 1237 (Ch)* monthly payments were made pursuant to a gym membership contract. The membership contract was held not to be a credit agreement as the payments were made for continuing access to the facilities, in relation to each month.

Contracts to supply services on an ongoing basis can be analysed as "severable" contracts – "completion" of each stage occurs for each month (or other period) of the supply. The consideration is divided up, with each instalment attributable to each month. Even if monthly payments are made in arrears (at the end of each month to which they are attributable), credit will not be provided. Hire agreements with periodic rental payments also fall into this category.

In contrast to severable contracts, "entire" contracts involve a single performance, with lump sum payment to be made at the end. For example, while monthly premium pay-as-you-go insurance policies will generally be severable (with each premium attributable to a month of cover), single premium insurance policies are entire contracts. However, there may also be difficulties identifying the time of completion in the context of entire contracts for the supply of services.

In *Tilby v Perfect Pizza Ltd [2003] CCLR 9*, the Court considered a single premium after-the-event (ATE) insurance policy, which was an entire contract. Somewhat unusually for such policies, payment of the premium was not required until the conclusion of the litigation, that is when the insured risk arose. It was argued that this constituted credit. However, Senior Costs Judge Hurst held that there was no deferment. Since ATE insurance was a newly developed product, there was not yet an established business practice requiring such premiums to be paid at the inception of the policy.

It is difficult to identify when payment is "earned" by the insurer under an entire contract. If, as seems likely, completion of performance occurred when the insurer agreed to provide cover (rather than when the insured risk arose, or at the end of the period of cover), then there would indeed have been a deferment of the payment obligation. There is something unsatisfactory about deciding this question by reference to established practice for payment. *Tilby* illustrates the difficulties of applying Professor Goode's test – if one cannot pinpoint the time payment is earned then how can one tell if there has been deferment?

Reproduced from Practical Law Financial Services with the permission of the publishers. For further information visit practicallaw.com or call 0207 542 6664. Copyright © 2015 Thomson Reuters (Professional) UK Limited. All Rights Reserved.

Uncertainty at the time the agreement is made

Another point to note is that whether credit is being provided must be assessed at the time the contract is entered. If, at this date, it is uncertain whether in fact any benefit is being transferred, or whether any corresponding repayment obligation will arise, then there will not be credit. In *McMillan Williams v Range [2004] 1 WLR 1858*, CA an employer made advance payments of estimated minimum commission to an employee; if the employee reached those estimates, then there would be no need for repayment at the end of the fixed period. At the time the employment contract was made, it was uncertain whether there would be a surplus or a shortfall, and thus there was no credit.

Hire-purchase agreements

Professor Goode's formulation is no litmus test. For example, it does not work when applied to hire-purchase agreements. We know that hire-purchase agreements are a sub-category of credit agreements, because section 9(3) of the CCA tells us that they are. Yet the owner of the goods cannot be said to earn repayment of the purchase price until the property in the goods passes to the customer at the end of the term. Repayment is not being deferred in any sense. Unless and until the customer makes the final repayment, there is simply a bailment, as there is under an ordinary hire agreement (which is not credit). Accordingly, there is no deferment of repayment by virtue of the retention of title clause, but this very clause is fundamental to the character of a hire-purchase agreement.

The answer to this conundrum is probably that hire-purchase agreements are not true credit agreements. They are merely "treated as", or "deemed" to be credit agreements by section 9(3) of the CCA. Credit is not a hard-edged concept and overall Professor Goode's formulation ("contractual right to defer payment of a debt") is as workable a test as one is likely to arrive at.

Reproduced from Practical Law Financial Services with the permission of the publishers. For further information visit practicallaw.com or call 0207 542 6664. Copyright © 2015 Thomson Reuters (Professional) UK Limited. All Rights Reserved.