GOUGH SQUARE CHAMBERS' CONSUMER CREDIT COLUMN: JUNE 2016

This document is published by Practical Law and can be found at: uk.practicallaw.com/**0-629-2078**
Request a free trial and demonstration at: **uk.practicallaw.com/about/freetrial**

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

In the June column, Ruth Bala considers the judgment in *Nelmes v NRAM plc [2016] EWCA Civ 491*.

Ruth Bala, Gough Square Chambers

RESOURCE INFORMATION

RESOURCE ID

0-629-2078

RESOURCE TYPE

Article

PUBLISHED DATE

7 June 2016

JURISDICTION

United Kingdom

NELMES V NRAM AND SECRET COMMISSIONS

At the end of May 2016, the Court of Appeal handed down its latest judgment on secret commissions paid to brokers, *Nelmes v NRAM plc [2016] EWCA Civ 491*.

The court found that there was an "unfair relationship" under section 140A of the Consumer Credit Act 1974 (CCA), solely on the ground that a commission paid by the lender to the mortgage broker had not been disclosed to the borrower. The financial figures were varied throughout the offer process, but ultimately the borrower entered a loan of £2,148,300, secured over his buy-to-let portfolio. The borrower paid the lender an arrangement fee of £21,483 and he also paid the broker a broker's fee of £16,112.25. Unbeknownst to him, the lender transferred half of its arrangement fee (£10,741.50) to the broker, by way of commission. As a result, the intermediary broker was receiving commissions from both sides to the transaction, which was a very common practice at that time.

Distinction between secret commissions and PPI undisclosed commissions

To grasp the true cause of action for secret broker commissions, one must avoid conflating it with the cause of action for undisclosed payment protection insurance (PPI) commissions. Of course both causes of action involve undisclosed commissions, and following *Nelmes* it is now established that either may give rise to an unfair relationship. However, despite these superficial similarities, the underlying legal grievance is different.

In the context of PPI, the commission was paid by the PPI insurer to the lender/broker selling the policy and the commission represented a proportion of the price paid by the borrower for the actual product. In *Plevin v Paragon Personal Finance Ltd [2014] 1 W.L.R. 4222*, the Supreme Court held that an unfair relationship arose due to the high level of the commission, in combination with the fact that non-disclosure left the borrower unable to assess "whether the insurance represented value for money" (at [18]). She was unable to assess whether the PPI was value for money because she was unaware that a high proportion of the price (the premium) was being transferred to the lender as commission.

By contrast, secret commissions paid to brokers do not come out of the price paid by the borrower to purchase any product. The complaint in *Nelmes* was not that the borrower was unable to assess whether the lender's arrangement fee was value for money, even though the commission was deducted from that fee. Instead, the borrower's grievance was that, having paid the broker a fee, he expected the broker to act solely in his best interests, not to simultaneously receive a fee from the counter-party to the transaction. At the crux of this cause of action is whether the mortgage broker owes the borrower a duty to act solely in his best interests, a duty of undivided loyalty, namely whether he is the borrower's fiduciary agent.

Fiduciary duties

It is settled law that a mortgage broker is the borrower's agent (see, for example, *Plevin* at [33]). However, there is quite a leap from agency to fiduciary agency. In *Nelmes*, the Court of Appeal blandly states (at [34]) "[the Broker] was acting as agent for Mr Nelmes in his dealings with [the lender] and Mr Nelmes was entitled to his undivided loyalty". There is no analysis of why the broker was a fiduciary agent, rather than a mere agent, and no recognition of the distinction between the two.

The Hurstanger concession

Prior to *Nelmes*, the development of the law on secret commissions had been somewhat handicapped, frustrated at critical stages by novel points of law being determined on the basis of concessions, or without the benefit of adversarial argument. The present problems can be traced back to *Hurstanger Ltd v Wilson [2007] 1 W.L.R. 2351*, where the Court of Appeal held (at [33]) that the broker-borrower relationship was "obviously fiduciary". However, this point had been conceded (see [31]-[33]) and therefore the court heard no argument on it. It is unfortunate that *Hurstanger* has since been applied twice by the Court of Appeal, in *Nelmes* and prior to that in *McWilliam* (cited below) without recognising that the original decision was founded on a concession, and without hearing further argument on the point.

Hurstanger distinguished

It is startling that in neither *McWilliam* nor *Nelmes* does it appear that the Court of Appeal was referred to the series of decisions distinguishing *Hurstanger* in the period shortly afterwards. These decisions were all at county court level but were nonetheless reserved, carefully reasoned decisions from respected circuit judges. The county courts found themselves able to distinguish *Hurstanger* by expressly noting that it had been decided on the basis of a concession on this point.

Firstly, in *Yates and Lorenzelli v Nemo Personal Finance & another, (unreported), 14 May 2010, (Manchester county court)*, HHJ Platts distinguished *Hurstanger* and held there was no fiduciary relationship owed by the broker on the facts at [52]; although the borrower said she went to the broker to get the best possible deal, there was no evidence of what the broker actually said. For this reason the secret commission allegation was dismissed (although an unfair relationship was found on other grounds).

Secondly, in *Flanagan v Nemo Personal Finance, (unreported), 5 August 2011 (Manchester county court)*, HHJ Stephen Stewart QC distinguished *Hurstanger* and held there was no fiduciary relationship owed by the broker. The broker had said "we'll look through about 15 different lenders just to try and find the best offer"; this was insufficient to give rise to a fiduciary relationship where:

- There was brief and limited contact with the broker.
- The customer was not non-status, but an accountant himself.
- Prior to signing the agreement, he had been unaware of the broker fee, so had assumed the broker would be getting commission.

The judge held that the broker's discretion to select from a panel of lenders did not give rise to a fiduciary duty.

Thirdly, in *Sealey and Winfield v Loans.co.uk and GE Money Ltd, (unreported), 15 August 2011, (Mold county court)*, HHJ Jarman QC again distinguished *Hurstanger* and held there was no fiduciary relationship owed by the broker; the documents and transcripts showed this was "nothing more than the sourcing of a loan offer" by the broker.

It is also notable that while the Supreme Court in *Plevin* was not concerned with the *Hurstanger* cause of action, the court correctly characterised the broker as the borrower's agent and then commented (at [33]):

> "The practice by which the agent of a consumer of financial services is remunerated by the supplier of those services has often been criticised. It is, however, an almost universal feature of the business, and it is of the utmost legal and commercial importance to maintain the principle that the source of the commission has no bearing on the identity of the person for whom the intermediary is acting or the nature of his functions."

As far as the Supreme Court was concerned, the broker's receipt of commission did not detract from its role as the borrower's agent; neither was it inconsistent with that role (it was an entirely separate complaint that the extent of the commission made the borrower unable to evaluate whether the product was good value for money).

Thus, for a considerable period after *Hurstanger* (between 2010 and 2015), it appeared that the cause of action for secret broker commissions would be reserved for those special and unusual cases where the mortgage broker stepped outside his normal role as agent and took on the mantle of fiduciary.

Return to Hurstanger

The law started to lose its way when the Court of Appeal handed down its judgment in *McWilliam v Norton Finance (UK) Ltd t/a Norton Finance in liquidation [2015] C.T.L.C. 60* in March 2015, saying it was bound by Hurstanger to find that there was a fiduciary duty owed by the broker, without recognising that this issue had been conceded. Unfortunately the broker (Norton) was in liquidation, so was unrepresented; the CA comments [9] that this case was therefore a "very unsuitable vehicle" to determine issues of principle and at [31] notes it heard "no adversarial argument".

The *Hurstanger* approach has now been further cemented by the Court of Appeal in *Nelmes*, which described that case as representing "classic principles", again with no reference to the concession, or to the series of cases distinguishing it (at [34]). The court then casually referred to a broker's duties of "undivided loyalty" without any analysis of why such duties would arise in an ordinary borrower-broker agency relationship. As the Court of Appeal correctly noted (at [36]), the fact that undisclosed broker commissions were "not at the time uncommon" should not alter the legal analysis. However, their prevalence does make it all the more important that a full analysis at appellate level is undertaken. As it stands, an appellate assumption that a mortgage broker is a fiduciary agent appears to have emerged, as if by accident, without the issue ever having been argued before the Court of Appeal.