GOUGH SQUARE CHAMBERS' CONSUMER CREDIT COLUMN: FEBRUARY 2018

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In the February column, Thomas Samuels considers the interaction between the Consumer Credit Act 1974 (CCA) and the purchase of cryptocurrency.

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CONSUMER CREDIT ACT 1974 AND CRYPTOCURRENCY

Introduction

Cryptocurrency has been in the news repeatedly over the last few weeks. This has largely been the result of huge drops in the value of Bitcoin, which, at its peak, was valued at an astonishing unit price of $19,783. Further, there have been several recent high-profile cryptocurrency thefts, both online and in-person. The result of this media discussion has been that cryptocurrency has hit the public consciousness like never before. In turn, this has led governments, regulators and financial institutions to think seriously about the legal structures which are (or perhaps should) be in place to protect investors.

The first major lending institution in the UK to break cover on the issue was Lloyds Banking Group (LBG) which, on 5 February 2018, announced a ban on its customers purchasing cryptocurrency on their credit cards.

LBG's decision, and particularly the focus of the ban on credit card transactions, in turn leads to questions about the interaction between the Consumer Credit Act 1974 (CCA) and cryptocurrency purchases. This column considers that interaction in relation to two matters in particular: first, section 75 "connected lender liability" and, secondly, responsible lending under the Consumer Credit sourcebook (CONC).

What is cryptocurrency?

Before giving any substantive thought to the legal issues, it is important to understand what cryptocurrencies are, and how they are produced and sold.

The volatility in the price of cryptocurrency comes from the fact that it is, inherently, worthless. As such, its price depends upon the market believing that a unit of a particular cryptocurrency has value of "X" rather than "Y".

A unit of any given cryptocurrency is simply a line of computer code. To take Bitcoin as an example, the lines of code are created by an algorithm which produces and releases new Bitcoins, and will continue to do so, up to a total output of 21 million. As the total number in circulation approaches this limit, the production rate slows with new Bitcoins being released with evermore infrequency until the maximum number has been reached.

Bitcoins obtained a "real-world" value when those engaged in illegal online activities began trading them in exchange for contraband. For such purposes, cryptocurrency's advantage over actual money is security,

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through records held on the blockchain, in combination with anonymity. Sale and purchase of cryptocurrency is not recorded as being from person "A" to person "B", but rather by way of a transfer of information between anonymous digital "wallets".

As the value of Bitcoin and other cryptocurrencies increased through their use for funding illegal activities, they experienced a "cross-over" effect and thus became legitimate investments.

For the average person, cryptocurrencies are bought, sold and stored via digital currency exchanges (DCEs). These all operate in different ways but, fundamentally, act as a platform to enable the holder of wallet "A" to move cryptocurrency to the holder of wallet "B" and register the transaction accordingly. There are also a limited number of so-called cryptocurrency "ATMs", which operate in a similar way by connecting users to a DCE for the purchase or sale of cryptocurrency.

Section 75 liability

Section 75(1) of the CCA provides that if a debtor under a debtor-creditor-supplier agreement *"has, in relation to a transaction financed by the agreement, any claim against the supplier in respect of a misrepresentation or breach of contract, he shall have a like claim against the creditor…".*

In the first place, it must be borne in mind that most legislation is assumed to be "technology neutral". Thus, the mere fact the authors of the CCA cannot possibly have envisaged a cryptocurrency transaction, does not mean liability cannot accrue thereunder. However, the relative novelty of the technology which underpins cryptocurrency transactions does add a layer of complexity to its application.

The use of DCEs means that the precise contractual relations between the seller, purchaser, DCE and creditor are often far from obvious. Questions arise as precisely what "transaction" would be being financed, who the "supplier" is for the purpose of the provision and how to establish a "like claim".

To an extent, the answer to such issues depends upon the contractual terms put in place by the DCE in question. Inevitably they will define the scope of the service provided. Further, most include extensive limitation and exclusion clauses in an attempt to protect themselves from liability caused by fluctuations in value of the cryptocurrency. Therefore, a lender that faces section 75 claims in relation to cryptocurrency purchases would do well to start by looking at the precise terms of the consumer's agreement with the DCE. It may well be that a "like claim" simply cannot be established because the DCE's terms have been drafted to exclude such liability.

Moreover, because DCEs operate exclusively online, they can be based anywhere in the world and their terms may well be governed by foreign law. Of course, as established by *Office of Fair Trading v Lloyds TSB Bank plc [2007] UKHL 48*, of itself that does not exclude section 75 liability. However, it may make it far more difficult for the debtor to successfully establish and prove a breach of contract or misrepresentation claim – what would be sufficient in English law may not be sufficient under Californian law.

A more fundamental issue also arises as to who is the "supplier". The DCE's terms may provide that an investor's purchase contract is with the third-party seller. The likely consequence would be that any breach of contract claim would have to be made against him or her. However, that third-party would not be the "supplier" for the purposes of the CCA (being the person with whom the creditor has "arrangements" pursuant to sections 12(b) and (c) of the CCA).

In that regard, the difficulty echoes that in relation to holiday claims against travel agents under section 75. As here, the creditor's arrangements will be with the agent but the customer's contract will be with other third party suppliers of, for example, transport and accommodation. In the context of travel agents, the editors of *Guest & Lloyd's Encyclopedia of Consumer Credit note simply that no simple answer is available. It "will depend upon the precise contractual arrangements between the debtor, the travel agent and the provider of the services in each particular case"* (§2-067).

Thus, it seems likely that a similar analysis would have to be undertaken in relation to cryptocurrency transactions realised via a DCE.

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Responsible lending

Aside from the uncertainties of section 75 liability, there is a more immediate, and less technical, concern for creditors funding the purchase of cryptocurrency by regulated credit agreements. Namely, responsible lending.

For example, if a consumer pays £5,000 by credit card to fund their purchase of one unit of cryptocurrency, it may take them a year to clear that balance. However, during that period the value of the cryptocurrency may fall to £1,000 per unit. As a result, the consumer would be making repayments, with potentially substantial interest, for something worth only twenty per cent of its initial value by the end of the repayment period.

In particular, the FCA's Principles for Businesses (PRIN) listed in the Handbook at PRIN 2.2.1R might engage an overarching duty on consumer credit firms to avoid enabling customers to do so. For example: conducting business with "integrity" (Principle 1); conducting business with "due care, skill and diligence" (Principle 2); and, in particular, paying "due regard to customer's interests" and treating them "fairly" (Principle 6). These are expanded upon by various parts of CONC, including CONC 2 (Conduct of Business Standards: General), CONC 5 (Responsible Lending) and, in particular, CONC 6.7 (Post contract: business practices).

However, nothing in the FCA Handbook suggests that a creditor should monitor how a consumer spends the credit provided. Therefore, the real difficulty with funding cryptocurrency on credit card is the disparity of knowledge about the underlying transaction. An institutional lender will understand the volatility involved in a cryptocurrency investment in a way that the average customer may not. While the lender may not have any express duty to warn or advise about the nature of the investment, it is arguably in customers' interests to protect them from themselves.

GOUGH SQUARE CHAMBERS' CONSUMER CREDIT COLUMNS

For previous consumer credit columns written by barristers at Gough Square Chambers, see *Practice note, Gough Square Chambers' consumer credit columns.*

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