THOMSON REUTERS
PRACTICAL LAW™

Gough Square Chambers' consumer credit column: October 2021

by Ruth Bala, Gough Square Chambers

Status: **Published on 22-Oct-2021** | Jurisdiction: **United Kingdom**

This document is published by Practical Law and can be found at: **uk.practicallaw.tr.com/w-033-0795**
Request a free trial and demonstration at: **uk.practicallaw.tr.com/about/freetrial**

Ruth Bala, Lee Finch, Sabrina Goodchild and Thomas Samuels 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 2021 column, Ruth Bala considers the mechanics of rescinding a loan, focusing on the judgment on quantum in *Wood v Commercial First Business Ltd (dissolved) and others [2021] EWHC 1403 (Ch)*.

Rescission of a loan: the mechanics

Rescission of a credit agreement is a remedy gaining in popularity, due to its potentially high returns. To value the claim accurately, an understanding of the mechanics of rescission is first required.

We have a recent example in *Wood v Commercial First Business Ltd (dissolved) and others [2021] EWHC 1403 (Ch)*, the judgment of Mr James Pickering QC on quantum, following the Court of Appeal's dismissal of the assignees' substantive appeal on broker secret commission.

Cases where rescission is available

Rescission can of course be sought in cases of alleged mistake, fraud or misrepresentation. However, the principal category of case in which it is presently pleaded is broker secret commission.

Rescission is an equitable remedy, which is available where there has been a fraud at common law, or (subject to discretion) where there has been a breach of equitable duty. However, these causes of action are often statute-barred (more recent credit transactions disclose broker commission) and so borrowers rely on the "unfair relationship" provisions of the Consumer Credit Act 1974 (CCA). Although "rescission" is not included in the menu of remedies available under section 140B(1) of the CCA, orders for repayments and the taking of accounts can be made, such that "effective rescission" is available.

Fully secret cases

A fully secret case is a species of fraud; the transaction is voidable, so that the principal can rescind it, provided that counter-restitution can be made (*Panama and South Pacific Telegraph Co v India Rubber, Gutta Percha*, and *Telegraph Works Co (1875) LR 10 Ch App 515*). *Panama Telegraph* was followed in *Wood v Commercial First Business Ltd and others* and *Business Mortgage Finance 4 plc v Pengelly [2021] EWCA Civ 471*, where the Court of Appeal held that rescission was available as of right at common law, subject to making counter-restitution (at [101]). (For a column on the impact of the decision in this case, see Article, Gough Square Chambers' consumer credit column: May 2021.)

However, where the common law cause of action is statute-barred and so the borrower relies on the "unfair relationship" provisions, the position is not so straightforward. Relief under section 140B of the CCA is discretionary. *Nelmes v NRAM Ltd [2016] EWCA Civ 491* is a useful example of a fully secret case under the "unfair relationship" provisions where rescission was not awarded.

Half secret cases

In half secret cases, rescission is discretionary (*Wood and Pengelly, CA* at [128]). There is no reported case where it has been awarded and only exceptional facts would warrant it. In *Hurstanger Ltd v Wilson [2007] 1 WLR 2351,* the Court of Appeal observed that rescission would be disproportionate for a half secret case where the terms of the credit agreement were fair (at [51]).

Netting off repayments and advance

The borrower's right to restitution of all repayments they have made is subject to their ability to make counter-restitution of the principal advance. However, the borrower need not possess funds in the sum of the advance – the two payments may be netted off against each other. The basic premise is that the borrower will be reimbursed for all contractual interest and charges they have paid.

Borrower's entitlement to interest on the repayments

The appropriate starting point (and the basis for the award in *Wood*) is that the borrower is entitled to interest on each repayment they made, running from the date of each repayment (*Wood* quantum judgment at [16]-[17]).

The borrower in *Wood* sought such interest on a compound basis, as fully secret commission was a species of fraud. The High Court held that it had no jurisdiction in equity to award interest on a compound basis, as the cases did not fall within either of the two special classes of case where equity permitted such an award (*Wood* quantum judgment at [19]-[23]).

These limits to the equitable jurisdiction would not preclude a court awarding compound interest under the "unfair relationship" provisions. However, given that the objective of restitution is restorative rather than punitive (*Spence v Crawford [1939] 3 All ER 271* at 288-289), even under section 140B of the CCA, the court should not award compound interest unless, for example, the borrower adduces plausible evidence that they would have used the excess funds to pay down other credit debts on which compound interest was charged.

In *Wood,* the borrower was awarded simple interest at 4% over the three-month LIBOR rate (the commercial borrowing rate for a person with her credit profile at the relevant time).

Creditor's entitlement to interest on the advance

Equally, the creditor is entitled to interest on the principal advance from the date it was made (*Wood* quantum judgment at [16]-[17]). This is sometimes referred to as an "award for use of capital". In *Wood,* the assignees were awarded simple interest at 2% over the three-month LIBOR rate (the cost of borrowing funds to a secondary lender in the original creditor's position at the relevant time).

It does not appear that the assignees in *Wood* sought interest at the contractual rate under the mortgages. The justification for the contractual rate is that when restoring a creditor to its original position, the most likely counterfactual is that the creditor would have lent the funds to another individual, not that it would not have borrowed them from the market. Such an argument was accepted by Recorder Yip QC in *Lancashire Mortgage Corporation Ltd v Richardson* (unreported, Manchester county court, 13 January 2017). In that case I relied upon *Benedetti v Sawiris [2014] A.C. 938* as authority that in making an award for use of capital, the court must perform an objective market valuation of the benefit (that is, the advance) by reference to the personal characteristics of the borrower, such as their credit rating. Upon granting restitution of the bridging loan, the Recorder awarded the creditor 2% per month on the principal advance (the contractual rate).

Debt consolidation

Complications may arise upon rescinding an advance which has been used to redeem other debts at higher interest rates. Although the mortgages in *Wood* were refinancing transactions, this topic is not covered by the judgment.

If the advance has been used to refinance debts at higher interest rates, then one benefit conferred by the advance is that it has reduced the amount of contractual interest the borrower needed to pay. Prior to taking an account, disclosure of the refinanced debts should be sought, to ascertain their interest rates and term.

When granting restitution, the court must avoid unjustly enriching either party. Although the availability of rescission is consequent upon a wrong, its operation is purely restorative. Therefore, credit should be given by the borrower for the reduced interest they had to pay as a result of the refinancing.

Increase in equity of property

If a loan is used to finance the purchase of a property, or to finance home improvements, then credit should be given by the borrower for the equity increase they have enjoyed as a result of the transaction. Again, this is because when granting restitution, the court's objective is restorative.

In *Wood,* the mortgages had not been used to finance the purchase of property, but to refinance prior mortgages which had themselves been used to finance the purchase of property. The assignees sought an award to represent a reasonable "rent" for the borrower's continued ability to occupy the land as a result of the refinancing, but this was declined by the court.

Conclusion

Taking into account all of these considerations, rescission may not be as valuable a remedy as at first appears. This is because the making and accepting

of loans is often mutually beneficial for creditor and borrower alike. Rescission entails an unravelling of the benefits on both sides.

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 column.