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Court of Appeal hands down decision in motor finance test case

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In a judgment with implications far beyond motor finance industry, the Court of Appeal has dealt a blow to lenders in a motor finance test case.

On 25 October 2024, the Court of Appeal handed down judgment on Johnson v FirstRand Bank Ltd, Wrench v FirstRand Bank Ltd and Hopcraft v Close Brothers Ltd, three test cases concerning the payment of commissions to car dealers arranging motor finance. The Court of Appeal ruled that in each of the cases before them, it was unlawful for car dealers to receive a commission from a lender providing motor finance to a customer, unless it was properly disclosed to the customer and they gave informed consent to the payment.

Background

In all three cases, the claimants visited car dealerships with the intention of purchasing a vehicle. The car dealers assisted the claimants in obtaining a loan from third-party lenders to fund the purchase. The claimants subsequently entered into credit agreements with the lender defendants following the relevant introduction by the car dealers. In turn the car dealer received a commission – which the car dealer had some degree of discretion in setting – from the lender for arranging the credit agreement. In one of the cases the commission arrangement between the lender and car dealer was concealed from the claimant entirely. Whereas in the other two cases, the claimants did not know and were not told that a commission was to be paid. However, the lender's standard terms and conditions for the loans made reference to the fact that commission *may* be paid to the car dealer. The Court of Appeal characterised this scenario as a "partial disclosure".

The decision

The Court of Appeal ruling was rooted in common law principles of fiduciary duty rather than the FCA Rules. Significantly, all three of the credit agreements were made prior to the FCA's ban on difference in charge commission models in 2021 and the implementation of the Consumer Duty in 2023. We can therefore only speculate as to whether there would have been a different basis for the findings had the credit agreements been advanced under the current FCA regime.

In any event, applying common law principles, the Court of Appeal upheld all three appeals in favour of the claimants. It found that in acting as credit broker, the car dealers owed a "disinterested duty" to their customers (i.e. a duty to provide information, advice or recommendation on an impartial or disinterested basis). Additionally, the car dealers also owed in tandem with the disinterested duty an "ad hoc fiduciary duty" to the customers, which required them to act with loyalty and avoid conflicts of interest. In all three cases the Court of Appeal determined that there was a conflict of interest and no informed consent by the customer to the receipt of the commission.

In the case of *Hopcraft* where a “fully secret” commission was paid, the Court of Appeal found primary liability on the part of the lender. The cases of partial disclosure were more complex and required an examination by the Court of Appeal as to whether (i) the disclosure made to the customer was sufficient to negate secrecy; and (ii) by extension, whether the customer had given fully informed consent to the payment of the commissions. In each case, the Court of Appeal found that disclosure was insufficient:

- in *Wrench* the Court of Appeal ruled that disclosure “buried in the small print of FirstRand’s standard terms” was not enough to negate secrecy. Like in *Hopcraft*, the payment of the commission was deemed secret and the lender was therefore the primary wrongdoer; and
- in *Johnson*, whilst there was sufficient disclosure to negate secrecy, the Court of Appeal found that this was insufficient to procure the customer’s fully informed consent to the commission. Rather than being the primary wrongdoer in these circumstances, the Court of Appeal found the lender could only be held liable in equity as an accessory to the credit broker’s breach of fiduciary duty.

For Johnson’s claim only, the Court of Appeal also considered whether the commission arrangements created an unfair relationship for the purposes of section 140A Consumer Credit Act 1974. The Court of Appeal found that there was an unfair relationship due to the very high commission (being 25% of the sum advanced) and the lack of disclosure regarding the relationship between the lender and broker. The judgement did however make clear that a relationship will not be automatically unfair because a credit broker receives a commission and the customer is not actually aware of that fact. However, if the commission is very high in relation to the sum borrowed that may, in and of itself, be enough to make the relationship unfair where nothing, or nothing of substance, has been done to disclose the relationship between the lender and the credit broker.

The Court of Appeal ordered the repayment of the commission to Johnson, along with interest. Given the length of time since Johnson sold the car, it was found not to be appropriate to rescind the credit agreement.

Implications of this ruling

The implications for the lending market following this ruling cannot be underestimated. Both original lenders and purchasers of consumer debt will need to assess the extent of their liability in light of this judgement.

For firms

Lenders will need to review their procedures prior to advancing further loans as well as reviewing past practices. For example, they should consider whether existing commission arrangements comply with their conflicts of interest policy and/or any enhancements to the policy are required to ensure conflicts are identified and suitably managed.

Attention should also be paid to the customer journey, specifically how arrangements with credit brokers are described and the nature and extent of commission disclosures in the customer documentation. Lenders should also consider whether the Court of Appeal’s decision necessitates a product review (from both a product design and distribution strategy perspective) given the requirement under the Consumer Duty for firms to consider the end customer in the distribution chain.

Anticipating the possibility of a major surge in claims from both individual claimants and claims management companies alike, the FCA had warned motor finance firms in April this year that they must continue to maintain adequate financial resources. In particular, firms were told to examine their own circumstances to ensure planning for any additional operational costs from increased complaints and, where applicable, to meet the costs of resolving those complaints.[1]This will be an even more important consideration for firms in light of the judgment.

The FCA has said that it is carefully considering the judgement and it remains to be seen what further action the FCA will deem necessary. Nikhil Rathi, the FCA's chief executive, also discussed the ruling in a speech on 29 October 2024 stating the need for clarity on whether this is the Court of Appeal's final word on the issue. It is expected that the lenders will seek permission to appeal from the Supreme Court.

Mr Rathi further reminded firms that the FCA has extended the pause to the time firms have to provide a final response to customers about motor finance complaints involving a discretionary commission arrangement until December 2025. He also confirmed that the FCA is considering expanding the pause to cover complaints relating to other types of commission in motor finance.

For loan receivables securitisations

Further, the full impact of the ruling on the car loans receivables funding market remains to be seen.

Prior to the decision of the Court of Appeal, securitisation prospectuses had included legal and regulatory risk factors addressing commission arrangements. Those risk factors were framed to the effect that additional focus on this area, including increased scrutiny, regulatory proceedings and the possibility for redress payments, might impact the ability of the relevant issuer to make payments on the notes. In certain deals, these risk factors have been accompanied by specific trigger events relating to non-disclosure of the amount of broker commission, unfair relationship awards or the relevant car finance agreement being found to be illegal or invalid.

Issuers of securitisations are therefore likely to be keen to understand whether they face any liability flowing from prospectuses containing misleading or otherwise inaccurate information on the risk relating to the potential for making compensatory payments in respect of undisclosed commissions. In addition, originators (or sellers) of receivables in car finance funding structures will be eager to assess their potential liability in relation to buyback and/or indemnity claims for losses suffered by the relevant issuer as a result of that originator's commission arrangements.

Going forward, compliance warranties in receivables purchase agreements will also need to be carefully negotiated where these are subject to awareness and a commercial agreement will need to be reached regarding responsibility for any remediation exercises in the context of credit broker commission arrangements.

[1]FCA statement regarding motor finance firms' financial resources | FCA