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Compliance Monitor

September 2016

Nelmes v NRAM plc: the latest twist in brokers' fiduciary duties

The Court of Appeal recently ruled there was a breach of duty where a broker had received commission from a lender, unbeknown to the client, who also paid the broker directly. The Court's finding of an unfair relationship created by payment of the procuration fee could lead to more significant remedies in other cases, depending on the facts, says **Jason Woodland**.

On 26 May 2016, in *Nelmes v NRAM plc* [2016] EWCA Civ 491, the Court of Appeal ruled on an unfair relationship claim arising from a loan made by Northern Rock plc (now named NRAM plc) (NR) to Thomas Nelmes to re-finance a portfolio of buy-to-let properties.

The Court held that the relationship was unfair under section 140A of the Consumer Credit Act 1974 (CCA) on the basis that an undisclosed agreement had been struck between NR and the borrower's mortgage broker under which a procuration fee was paid.

Background

In addition to his home, Mr Nelmes owned a portfolio of 25 buy-to-let residential properties in Huddersfield.

Mr Nelmes wanted to consolidate his borrowing from one lender and to obtain additional funds without having to charge any more properties. He therefore instructed a mortgage broker to act for him in undertaking a re-financing process.

The broker arranged financing with NR, who would provide a loan of £2,148,300 secured over the buy-to-let portfolio and Mr Nelmes' home.

The loan arrangements were subject to an agreed maximum loan-to-value ratio (LTV) of 70%. Mr Nelmes paid an arrangement fee of £21,483 to the lender and, in addition, a broker fee of £16,112.25. However, without Mr Nelmes' knowledge, the lender paid half of the arrangement fee (£10,741.50) to the broker by way of commission.

In 2008, Mr Nelmes experienced financial difficulties and fell behind with payments due under the financing arrangements. In 2011 NR indicated that they wanted a revaluation of the property portfolio and in 2013 NR carried out drive-by valuations. As a result of the portfolio being re-valued, the LTV ratio had risen to 148%, well above the 70% LTV agreed when the financing had been put in place.

After this, on 15 July 2013, NR made a formal demand for repayment of the entire outstanding debt within seven days and threatened enforcement action over the portfolio (including Mr Nelmes' home) if the payment was not made by 6 August 2013. At the same time NR invited Mr Nelmes to make a proposal to resolve the issue by 30 July 2013.

No proposal was made by Mr Nelmes, so NR appointed receivers on 31 July 2013, six days before the deadline for enforcement they had given.

Leeds County Court decision, 18 July 2015

In April 2015, Mr Nelmes brought proceedings in Leeds County Court in which he claimed that the relationship between him and NR arising out of the relevant agreements was unfair because one or more of the matters specified in section 140A CCA applied, and asked the Court to grant him relief. He relied on a variety of grounds, which included matters at the time that the mortgage was entered into and the conduct by NR during the course of the agreement.

The scope of grounds for unfairness under section 140A is extremely wide and can include any contract terms, the way in which a creditor has exercised its rights, or any other thing done (or not done) by, or on behalf of, the creditor.

In a judgment dated 18 July 2015, Mr Recorder Cadwallader declined to find any aspect of the relationship unfair, except in relation to the matter of NR appointing receivers six days early.

The judge held that the terms in question were commonplace for products of the kind, Mr Nelmes was experienced in the buy-to-let field and he was not under any pressure to execute the agreement to refinance. Mr Nelmes could have gone elsewhere had he not been happy with the proposal from NR. Further, it was found that NR had been restrained in its actions in light of Mr Nelmes' ill health; once the arrears had started and the revaluations were obtained, the making of the demand for repayment became inevitable.

However, the Court went on to find that NR's appointment of receivers six days before the date NR had itself set for enforcement was unfair. Despite this fact, Mr Nelmes had failed to make any payment proposals at all. Even if receivers had not been appointed until a reasonable time later, say a month, it would have made no substantial difference. Accordingly, the Court determined that a remedy under section 140B CCA (which sets out the powers of the court in relation to unfair relationships) was not justified.

Court of Appeal decision, 26 May 2016

Mr Nelmes appealed that decision. The Court of Appeal determined that Mr Cadwallader Recorder was entitled to conclude that, with the crucial exception of his treatment of the procuration fee, that there was no unfairness in the relationship between NR and Mr Nelmes, which required the Court to use its powers under section 140B CCA.

With respect to the procuration fee, Clarke LJ held that Mr Nelmes was entitled to the broker's "undivided loyalty". The payment of the procuration fee by NR of 0.5% of the sum advanced, being half the arrangement fee payable by Mr Nelmes, was kept secret from Mr Nelmes. Its acceptance by the broker, who was also paid by Mr Nelmes directly, was a breach of the duty owed by him to Mr Nelmes. That breach of duty was brought about by NR by the payment of the procuration fee.

As a result of the secret payment there was an unfair relationship. Accordingly, the commission paid by NR to the broker (plus interest) was to be returned to Mr Nelmes in order to rectify the unfairness.

Comment

The law in this area has in recent years been in great flux, with *Nelmes* representing the latest twist.

The Court of Appeal in *Nelmes*, in reaching its decision on secret commissions, relied on the decision in *Wilson v Hurstanger* [2007] EWCA Civ 299. In that case, in which a broker negotiating a loan was paid a fee by his consumer clients as well as a commission from the lender, the Court of Appeal held that the broker-borrower relationship was "obviously a fiduciary one". The consequence of the fiduciary relationship was that it automatically rendered any payment that had not been properly disclosed to the clients a secret commission with all the consequences which flow from that.

The decision in *Hurstanger* has subsequently been distinguished in three county court judgments, handed down between 2010 and 2015. However, and very importantly, the fiduciary duties point was conceded in *Hurstanger* and the court therefore heard no argument on it.

Do brokers owe fiduciary duties to the client?

In each of *Yates and Lorenzelli v Nemo Personal Finance & another* (unreported), 14 May 2010 (Manchester County Court), *Flanagan v Nemo Personal Finance* (unreported), 5 August 2011 (Manchester County Court), along with *Sealey and Winfield v Loans.co.uk and GE Money Ltd* (unreported), 15 August 2011 (Mold County Court), the Court held that (on the facts of each case) a fiduciary duty did not arise between the broker and the client. The common theme running through these cases was that there was no significant communication between the broker and the customer: most of the contact appeared to be short and unremarkable, and was clearly not sufficient for any of the judges to conclude that a fiduciary duty had arisen.

The Court of Appeal took a different approach. In *McWilliam v Norton Finance (UK) Ltd t/a Norton Finance in liquidation* [2015] CTLC 60, a year before the decision in *Nelmes*, the Court of Appeal continued the principle developed in *Hurstanger*.

The Court stated that it was bound by the decision in *Hurstanger* to find there was a fiduciary duty owed by the broker, notwithstanding that the issue had been conceded in that case. Moreover, the broker in *McWilliam* was unrepresented (he was in liquidation) and therefore the Court of Appeal issued a caveat that the case was therefore a "very unsuitable vehicle" to determine issues of principle.

The future

Perhaps unsurprisingly, the Court of Appeal in *Nelmes* did not examine this tripartite of cases distinguishing *Hurstanger*, or mention *McWilliam* (and the problems identified as inherent in the decision).

Rather, and to the contrary, the Court suggested that Mr Nelmes was entitled to recover the amount of the commission paid by NR to the broker on the basis of "classic principles".

It is unlikely that there will ever be a conclusive answer to the question of whether a mortgage broker owes fiduciary duties to its customer because fiduciary duties depend on the nature of the relationship between broker and customer. However, given the potential impact this question has on issues of unfairness under the CCA, some clarification of the current position would be a welcome development.

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