Court of Appeal considers whether increasing rates on business tracker mortgages is unfair

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Banking & Finance/Commercial/Dispute Resolution/Financial Services/In-House Advisor/Property: A lender took a decision to increase rates on its tracker mortgages. These mortgages had a rate of 1.99% over the Bank of England base rate. The lender decided to add an additional 2% per year premium to this rate for customers who had 3 or more 'buy to let' mortgages with the lender. The customers challenged the rise as being unfair. David Bowden, freelance independent consultant, notes the submissions made to the Court of Appeal on 28 April 2016 in Alexander v. West Bromwich Mortgage Company Limited and talks to Malcolm Waters QC at Radcliffe Chambers in London about the implications of this case for financial services practitioners.

Original news

Mark Robert Alexander (as a representative of the Property 118 Action Group) v West Bromwich Mortgage Company Limited

A3/2015/0561 28 April 2016

Court of Appeal, Civil Division (Sir Brian Leveson P, Sharpe & Hamblen LJJ)

The Court of Appeal has heard submissions and reserved judgment in this case. A lender took a decision to increase rates on its tracker mortgages. These mortgages had a rate of 1.99% over the Bank of England base rate. The lender decided to add an additional 2% per year premium to this rate for customers who had 3 or more 'buy to let' mortgages with the lender. The customers challenged the rise as being unfair. It was accepted by both sides that these loans were not consumer contracts. An action group of all affected borrowers was formed and proceedings were brought for a declaration that the lender had no right to make this rate rise. In the Commercial Court, Teare J ruled that the lender was not prevented from increasing its rates in this way and dismissed the challenge **[2015] EWHC 135 (Comm).** *The action group appealed against this ruling to the Court of Appeal.*

What is the significance of this case?

David Bowden (DB): The terms in the lender's mortgage documentation are similar to those found in standard mortgage forms across the industry. These terms include a provision to vary the interest rate subject only to notice and one to terminate a mortgage contract (even where there is no default) subject only to 30 days' notice. The Court of Appeal has previously determined cases before in this area which were governed by consumer law. This is a wider challenge to the rights of lenders to vary and set interest rates. The way the appeal was presented means that any ruling would apply not just to consumer lending but to business and commercial lending too.

What are the facts?

DB: The facts were not in dispute and the loan documentation relating to Mr Alexander was treated as representative of all other borrowers in the action group. Mr Alexander took out a mortgage with the lender. This was for 25 years on an interest only basis. It was to finance a property Mr Alexander intended to buy to let out ('BTL'). The loan offer dated 6 June 2008 had these financial details:

- Loan amount: £90,299,
- Initial interest rate: 6.29% fixed until 30 June 2010, and
- Subsequent interest rate: Bank of England Base Rate with a premium of 1.99%.

There was a suite of documentation that the court was taken to comprising:

- Offer of loan letter dated 6 June 2008,
- Acceptance of offer,
- Information you need to know about your mortgage – general information,
- Standard conditions of offer,
- Mortgage Conditions 2006 (daily interest),
- Mortgage special conditions, and
- Mortgage Deed.

The PAG118 borrowers are not regarded as 'consumers' under the Unfair Contract Terms Directive (**93/13/EEC**) ('UTCD') because it defines consumers as '*any natural person who, in contracts covered by this Directive, is acting for purposes which are outside his trade, business or profession*'. As buy to let landlords with 3 or more mortgages will in many cases be running a business they will not fall within this provision.

What ruling did Teare J give?
DB: On 29th January 2015, Mr Justice Teare ruled **[2015] EWHC 135 (Comm)** that the lender was not prevented from increasing its rates in this way. He dismissed the challenge from a group of buy to let investors who formed the PAG118. However, an application for permission to appeal that ruling was granted on the papers by Christopher Clark LJ on 14 May 2015.

What were the issues the Court of Appeal was asked to address?
DB: There were 2 issues before the Court of Appeal:

- Was clause 5 of the lender's standard mortgage terms (which did mention the right to vary interest rates in this way) a **term** of the mortgage contract or was the contract instead governed by the lender's mortgage offer (which did not so mention this right). Linked to this is should the terms of the mortgage offer prevail in the event of conflict?
- Was the 1st bullet point of condition 14 of the lender's standard mortgage conditions a term of the mortgage contract? If so did it allow the lender to require borrowers to repay the loan on 1 months' notice even though the borrower was not in breach of the loan and had made all payments promptly?

What does the appellant action group (PAG118) say?
DB: PAG118 says that the decision of Teare J is wrong. PAG118 submits that it is 'impressionistic' from the documentation that these BTL mortgages were sold as tracker mortgages with a rate which would track the Bank of England base rate with a premium of 1.99% after any initial fixed rate period ended. PAG118 says the offer documentation makes this tracker deal clear and it is only in the mortgage conditions that it is said that there is a right to vary interest rates on notice. PAG118 accepts that the mortgage documentation used by this lender was used not just for business BTL borrowers but for all secured lending business that this lender offered. PAG118 says the mortgage conditions are irreconcilable with the offer of loan and therefore the offer of loan terms must be given precedence.

For the appeal, Mr Michael Ashcroft QC was instructed to lead (he did not appear below). He was the counsel for the successful appellants in the Supreme Court in *Rainy Sky* **[2011] UKSC 50.**

Are there any prior authorities on what happens when contractual documents conflict with each other?
DB: There are 2 prior authorities from the Court of Appeal which deal substantively with this. They were in the authorities bundle and referred to at 1st instance and appeal hearings. Firstly in *Pagnan SpA v. Tradax Ocean Transportation* **[1987] 2 Lloyd's Rep 342** ('*Pagnan*') Bingham LJ said '*It is not enough if one term qualifies or modifies the effect of another; to be inconsistent a term must contradict another term or be in conflict with it, such that effect cannot fairly be given to both clauses*.'

Secondly in *RWE Npower Renewables Ltd v. JN Bentley Ltd* **[2014] EWCA Civ 150** ('*Bentley'*) Moore-Bick LJ said that where the contract provides that one contractual document is to take precedence over another it was '*only in the case of a clear and irreconcilable discrepancy'* that it would be necessary to resort to the agreed order of precedence. The Court of Appeal approved Akenhead J below who ruled that '*the court's task is not simply to examine one contractual provision and compare it with another. The court's task is to read the provisions together and, if possible, give sensible effect to each of them*.'

For the appeal, PAG118 relied also on 3 further authorities. The well-known case of *Glynn v. Margetson* **[1893] AC 351** concerned a bill of lading for a consignment of oranges which were to be transported from Spain to England. The printed terms allowed the ship to proceed by any port or sea whatsoever. The House of Lords held however that the printed clause must not be construed so as to defeat the main object and intent of the contract, which was to carry the oranges from Malaga to Liverpool and that the liberty must be restricted to ports which were in the course of the voyage. It held the deviation in question was not justified.

In *Rainy Sky* **[2011] UKSC 50** Lord Clark said that '*the ultimate aim of interpreting a provision in a contract, especially a commercial contract, is to determine what the parties meant by the language used, which involves ascertaining what a reasonable person would have understood the parties to have meant'* and also *'where a term of a contract is open to more than one interpretation, it is generally appropriate to adopt the interpretation which is most consistent with business common sense'*.

Finally and most recently in April 2013, HHJ Mackie QC in the London Mercantile Court in *Kuoni Travel Ltd v. Boyle* **[2013] EWHC 877 (QB)** had to construe a sale and purchase agreement ('SPA') for the purchase of share capital in a travel company whose terms were said to conflict with those of a tax deed. Judge Mackie found that the liability arises under the Deed not the SPA and went on to hold that '*I do not see the case law which discourages the finding of inconsistency in contractual provisions of much application to a specific clause providing for what is to happen in the event of a conflict'* and concluded that the *'purpose of Clause 5.7 is to protect the relevant terms of the Deed from contrary indications in the SPA'*.

What has the Court of Appeal previously decided on lender's rights to vary interest rates?
In *Paragon Finance plc v. Nash & Staunton* **[2001] EWCA Civ 1466** Dyson LJ ruled that the contractual power to vary the rate of interest is subject to an implied contractual term that the rates of interest '*would not be set dishonestly, for an improper purpose, capriciously or arbitrarily'* by the lender. Neither side sought to chip away or qualify this ruling.

Are there any prior authorities on lender's right to call in loans on notice where the borrower is not in default?
This is something that the courts have not had to rule on before in relation to financial services in this jurisdiction. However, in relation to commercial contracts there have been 2 observations in previous appellate cases that the borrowers rely on.

Firstly in an IT software contract case, the Court of Appeal in *Digital Integration Ltd v Software 2000* **[1997] EWCA Civ 787, [1998] ECC 289** said '*whether by reference to the likely commercial purpose of an exclusive distribution agreement anticipate to last for 2 years or simply by reference to business common sense, it seems to me that to adopt a construction…which renders the agreement virtually terminable at will is inappropriate*.'

Secondly in a shipping case the House of Lords in *Suisse Atlantique v. NV Rotterdamsche Kolen* **[1967] 1 AC 361** said '*one may safely say that the parties cannot, in a contract, have contemplated that the clause should have so wide an ambit as in effect to deprive one party's stipulations of all contractual force: to do so would be to reduce the contract to a mere declaration of intent*.'

What do the academic commentators say about this?
Lewison, the Interpretation of Contracts (5th edition) says that any contractual provision which purports to provide that a contract may be terminated without breach simply be giving notice must be interpreted in the context of the contract as a whole. What appears to be a free-standing right to terminate at any time may be construed as a more limited right especially where the contract purports to be for a fixed term.

The most recent update to *Emmet and Farand on Title* say this about the decision below:

> '*Remarkably, Teare J was able to construe the relevant Mortgage Conditions as "qualifying" or "complementing" the apparently absolute terms of the Offer of Loan, so that what the mortgagors (understandably, it might be thought) took to be 25-year tracker mortgages with interest rates pegged to Base Rates were in fact repayable at any time in the absence of default and at rates variable more or less at the mortgagor's discretion. Adopting an approach perhaps more appropriate for situations where the parties negotiate terms than for those where one party accepts non-negotiable standard form documents prepared by the other'*

What does the defendant lender say?
DB: Not surprisingly, the lender says that Teare J came to the right result for the reasons he gave in paragraphs 14-18 and 23. The lender stressed that mortgage contracts were long term ones that could stretch to the full 25 year term. It said the challenged term was there as a fall back to cover the unexpected. The lender had to concede that it had not insisted on claiming the full extra 2% premium and cited what it termed were 'improving market conditions'. The lender said initially it imposed a 2% premium, this dropped to 1.7% in June 2014, to 1.5% in November 2014 and to 1.2% in June 2015.

What interventions did the judges make? What points seem to be troubling them?
DB: All judges were aware of the wider implications of this case and the impact of any ruling. The court room was packed with many of the PAG118 members attending. Leveson LJ remarked at the beginning that if he knew so many would attend that he would have sold tickets.

Hamblen LJ questioned whether all the points now made by the PAG118 appellants were made below. Counsel for PAG118 said that the points he was making were all ones of construction. Hamblen LJ interjected to say that the 2% premium sought by the lender wasn't a rate of interest and the only rate of interest was the Bank of England base rate. Hamblen LJ then challenged the lender's counsel that what was being changed was <u>not</u> the interest rate at all but rather its profit margin. As to whether the lender's standard terms stood up to the challenge here, Hamblen LJ said this '*depends how clear you make it'*. Hamblen LJ asked if the documentation was so flexible that it would allow a lender to change the reference rate from the Bank of England to LIBOR subject only to notice. Surprisingly the lender's counsel said this would be possible - it would only depend on whether the variation was done under condition 5 or not.

Leveson LJ correctly noted that of all the 9 bullet points in condition 14 of the mortgage conditions (which set out the circumstances in which the lender could call in the loan), every one of those required some breach by a borrower except the first one which allowed the lender to require early repayment in full on 1 months' notice. The lender's counsel (acknowledging that this condition could not be exercised capriciously) feebly suggested it was there in case a lender wanted to exit a particular market. This cannot hold up to scrutiny because if that were the case a lender is more likely to first to seek to sell its portfolio. Leveson LJ pressed on the way condition 5 was drafted saying it would have been '*so easy to make that clear wouldn't it?*' The lender's counsel was forced to admit the clause could have been expressed in a different way. Leveson LJ questioned the lender's counsel as to whether the word 'currently' could have been used. He was referring to the offer letter which said the rate would be Bank of England base rate + 1.99%. Leveson LJ said it did <u>not</u> say 'Bank of England base rate and a premium **currently** 1.99%'. Leveson then remarked that the lender's letter to the PAG118 borrowers in fact gave them more than the 1 month's notice and also waived any exit charges.

Sharp LJ interjected to say the lender's documentation was assembled in that way to '*encourage people to sign up'*. Sharp LJ said there should be '*rational reasons'* for a lender to exercise its non-default termination powers. Sharp LJ was concerned about the imbalance created by the lending documentation. She noted that after the end of the initial 2 year fixed rate period, a borrower could re-mortgage and go elsewhere and said '*this was no skin off the lender's nose'*. Sharp LJ was concerned about the position of a borrower given 1 months' notice and who found himself unable to re-mortgage in that time frame (or at all) with another lender. The lender's counsel responded that these were industry standard terms and that borrowers had options which '*may not be great'*. Sharp LJ found the lender's approach to construction of the documents '*rather puzzling'* and said that to approach the issue of ambiguity the court should stand back and look at the transaction from '*a great height'*. Sharp LJ questioned how the non-default termination power could possibly fit in with the neutral and detached stance that the prior case law demanded.

What lessons can financial services practitioners learn from this case?
DB: Before he became an appeal court judge, Mr Justice Hamblen had to rule on a challenge by Mr Khan to standard from business contracts issued by Deutsche Bank. He dismissed **[2013] EWHC 482 (Comm)** all these challenges including those under the UTCD, the Unfair Contract Terms Act 1977 and the 'unfair relationship' one under section 140A of the Consumer Credit Act 1974. Mr Khan was seeking to avoid repayment of a £50million facility secured over high value properties. His challenge was heard over several weeks. At the end of it Hamblen J remarked that '*the defendants have fought those claims tooth and nail. A myriad of defences and claims have been raised to resist them. Many of them were abandoned….*' .

It is noteworthy here that the situation is the exact mirror image of Khan. In PAG118, the borrowers are not trying to wriggle out of paying at all but rather they are seeking to be able to keep precisely and exactly to the terms of the bargain they entered into with the lender.

Malcolm Waters QC (MW): As is standard practice in modern residential mortgage documentation, the mortgage offer in this case contained the terms specific to the loan to the particular borrower, with further terms of more general application being set out in the lender's standard mortgage conditions. As is also standard practice, the mortgage conditions provided that, in the event of a conflict between the offer and the mortgage conditions, the offer would prevail. The offer terms in the present case provided that, after an initial fixed-rate period, interest would be charged at '*a variable rate which is the same as the Bank of England Base Rate … with a premium of 1.99%, until the term end*'. Thus the key issue which the Court of Appeal has to resolve in this case is whether, as Teare J held at first instance, the offer terms are qualified by (rather than in conflict with) general terms in the mortgage conditions which enable the lender (i) to vary the interest rate (except during a fixed rate period) for any of the widely-drawn reasons there set out, and/or (ii) to give a non-defaulting borrower one month's notice requiring repayment of the loan before the end of the 25 year term.

It is tempting to approach this question by characterising the mortgage as a 25-year tracker mortgage and concluding that the general terms in the mortgage conditions which enable the lender to vary the interest rate or require repayment of the loan before the end of the term must by definition be in conflict with the offer and thus overridden by it. There is, however, a danger that this approach begs the question: the contractual documentation did not describe the mortgage as a tracker product and it is not clear that any promotional material which might have formed part of the relevant contextual background did so either. If one can resist the temptation to pre-judge the issue by starting from the premise that the mortgage is a 25-year tracker mortgage, it becomes less obvious that the description of the loan in the offer was sufficiently clear and unequivocal to prevail against the strong current of previous authority that, if possible, effect should be given to each of the terms of the contract, rather than one being rejected as irreconcilable with the other.

The observations of Hamblen LJ in the Court of Appeal do, however, raise the rather different question whether the lender's attempt to increase the differential over the Bank of England's base rate from 1.99% to 3.99% fell within the scope of the power in the mortgage conditions to vary the interest rate. His interventions on this point suggest that the increase may be held to fall outside the scope of the power on the basis that the lender was not seeking to vary the interest rate rather to increase its "profit margin". To put the point another way, the correct conclusion may be that, in attempting to increase the differential, the lender was not varying the interest rate but was attempting to change a component of the formula used to determine the interest rate – which, arguably, is a different thing.

What should lawyers do next?
DB: At the end of the hearing Sir Brian Leveson said the court would reserve its judgement. A draft judgment will be circulated in due course for any typographical errors to be corrected. The President gave no indication as to when judgment will appear but it is more likely to appear this side than the other of the summer 2016 recess. When this appears whatever it says, all lenders will need to review all their terms and conditions (not just those applying to mortgages) to ensure that any gaps are plugged.

MW: It is important to bear in mind that it was common ground in this case that the borrower was not a 'consumer'. The Court of Appeal is thus concerned with a pure question of contractual construction and does not have to decide whether the terms relied on by the lender (if not overridden by the offer) can be upheld as fair under the Unfair Terms in Consumer Contracts Regulations 1999 (since replaced by Part 2 of the Consumer Rights Act 2015). The assumption that the borrower and the other borrowers represented by him were not 'consumers' because they had 3 or more buy-to-let properties may not be a safe one to make in all cases. For example, in a case where the borrower has bought three or more buy-to-let properties as a part of a retirement plan or as a long-term savings vehicle, the better view may be that the purchase (and any mortgage used to fund it) should be seen as an investment rather than a business transaction: compare *OFT v Foxtons* **[2009] EWHC 1681 (Ch)** at [28].

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