Court of Appeal considers mortgage condition challenge

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Dispute Resolution analysis: David Bowden, freelance independent consultant, notes the submissions made to the Court of Appeal in Alexander v West Bromwich Mortgage Company Ltd and talks to Malcolm Waters QC at Radcliffe Chambers about the implications of this case for financial services practitioners.

Background

Alexander (as a representative of the Property 118 Action Group) v West Bromwich Mortgage Company Ltd A3/2015/0561 28 April 2016

The Court of Appeal has heard submissions and reserved judgment in this case concerning a challenge to a lender's decision to increase rates on its tracker mortgage. In the Commercial Court, Teare J ruled that the lender was not prevented from increasing its rates in this way and dismissed the challenge (see Alexander (as representative of the Property 118 Action Group) v West Bromwich Mortgage Company Ltd [2015] EWHC 135 (Comm), [2015] 2 All ER (Comm) 224). Property 118 Action Group (PAG 118) appealed against this ruling to the Court of Appeal.

For discussion of the decision in the Commercial Court, see Mortgage conditions not inconsistent with offer terms on rate change (Alexander v West Bromwich Mortgage Company).

What were the issues the Court of Appeal was asked to address?

David Bowden (DB): There were two issues before the Court of Appeal:

- Was condition 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?
- Was the first 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 one months' notice even though the borrower was not in breach of the loan and had made all payments promptly?

What does PAG118 say?

DB: PAG118 submits that it is 'impressionistic' from the documentation that these 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 says the mortgage conditions are irreconcilable with the offer of loan and therefore the offer of loan terms must be given precedence.

What does the defendant lender say?

DB: The lender says that Teare J came to the right result for the reasons he gave. 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.

For more detail on the authorities cited in the hearing and the academic literature on these issues, see: The case law behind Alexander v West Bromwich Mortgage Company.

What interventions did the judges make? What points seem to be troubling them?

DB: 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 not 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 nine 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 one months' notice. 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 not say 'Bank of England base rate and a premium currently 1.99%'. Leveson LJ said it would have been 'so easy to make that clear wouldn't it?'

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 two-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 one months' notice and who found himself unable to re-mortgage in that time frame (or at all) with another lender. 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?

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'.

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:

- to vary the interest rate (except during a fixed rate period) for any of the widely-drawn reasons there set out, and/or
- 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 in this approach—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 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 but 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?

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, SI 1999/2083 (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 three 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 *Office of Fair Trading v Foxtons* [2009] EWHC 1681 (Ch), [2009] All ER (D) 110 (Jul) at para [28]).

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