Asset lenders should beware of Unfair Relationships

By David Bowden
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On 10 December 2009 in Patel v. Patel a claim for £6m was reduced to £200k following a two-day trial in which the borrower was represented by Andrew Davies of Henderson Chambers. The case will have a significance for asset lenders.

The two Patels in this case were unrelated to each other. The judge found that the relationship was unfair for four reasons:

• the fixed rate of interest was payable no matter how the borrower's business fared;

• no longer seed capital – but rather finance to an existing profitable business and was lower risk;

• the 20% interest rate – there was no evidence that this was a reasonable rate to charge; and

• the 20% fixed interest rate was exorbitant when judged against bank base rates now at 0.5%.

The loans

The initial loan of £16,450 was to finance the purchase of a newsagent's business called "Wests". This was made between 1979-1981 when the Consumer Credit Act 1974 (CCA) only regulated lending of £5000 or less.

A further loan of £39,075 was made to buy a Londis shop in Swindon in November 1983 – and this was not CCA regulated either.

The Judge found that the lender Patel (a chartered accountant) was more experienced in business than the borrower. The Judge found the relationship between the two Patels to have been exercised in an unfair manner and that the borrower had been deferent to the lender.

Although payments were made over the years – they were made only sporadically and when the lender had chased the borrower up on the occasions he had been present in the UK.

Inherently improbable

Counsel for the borrower submitted that is was inherently improbable that he would have agreed to the terms, as such terms would have made no commercial sense and would have rendered his businesses uneconomic.

The order effectively wipes out any claim to compound interest over 17 years and merely allows the lender to recoup the capital sums. The Judge refused to grant an order that the defendant not have to pay anything because he found that the borrower never believed that the debts had been forgiven by the lender.

He said: "It is plain from the width of the provisions that the intention is to give the court a very wide discretion to make whatever order it thinks just. But in principle it seems to me that the order made should reflect and be proportionate to the nature and degree of the unfairness which the court has found."

The borrower is 81 years old. Although an appeal was considered in the case, Dinesh Dass of Premier Solicitors in Bedford who acted for the lender said that their client had decided not to appeal because even if he won he doubted whether he would

recover any more money that the Judge had awarded.

Limitation on Unfair Relationship claims

In Patel the Judge looked at section 8 of the Limitation Act 1980 which has a 12-year cut-off point for actions on "specialties". The judge said there was not a 12-year limitation period for these unfair relationship claims.

The Judge drew support for this from an old 1897 Court of Appeal case where an out-of-time claim for an unpaid solicitor's bill was refused because of the Limitation Act. However the court said this did not take away the right to be paid – it merely affected the procedure for enforcing it.

If Patel is correct on this – then asset finance providers face claims without any limitation on time – so lenders cannot be complacent on this. This could pose obvious problems for document and record production to defeat these claims. This would be made worse if there had been a course of dealings over many years and refinancing or upgrades of vehicles, plant or machinery.

Concerns for asset lenders

The ruling that an interest rate of 20% is an "unfair relationship" should be of concern to asset finance providers.

Although there was expert evidence before the court on handwriting, the court did not have any such evidence as to what was the market rate in asset finance, how this varied or how the risk factors were factored in. Defaulting borrowers may use the opportunity to try and say any finance where the APR is for more than 20% is an unfair relationship – but this is too crude – and courts in future cases will need to assess all the competing factors with some care.

Part of the unfair relationship finding was that the interest rate payable was fixed at 20% but bank base rates varied and were now at a historic low of 0.5%. A lot of asset finance is priced in this way. Again this finding by the court is too crude and will need refining in future cases. Asset finance providers in the meantime may start to see challenges where the lending rate is fixed from claims farms who allege that this makes the arrangement automatically an unfair relationship.

Pricing differentials

The Judge's views on the pricing differentials between seed capital and refinancing capital are interesting. He said that financing for an established business which is profitable should be cheaper than finance for a start-up business. Again this was not supported by any expert evidence. It ignores whether there is a guarantee or if the business is a franchisee or the track record of directors, shareholders or others involved in running the business.

Asset finance providers in the meantime may face claims from defaulting debtors to reduce the amount they pay – and if they are advised by claims farms they may see some probing questions from them about the rate differentials;

The lender in Patel is not an FSA regulated bank – and as the borrower's and lender's families had known each other for other 50 years - this coloured the Judge's views. The Judge said it was unlikely the borrower would have been able to get a bank loan. The personal chemistry issues are likely to be less of an issue for lending by mainstream lenders but the influence of front-line sales staff could still be an important issue;

Further advances

This case concerned two business loans – not consumer lending. There was a repeated course of dealings with further advances. The borrower had received

professional advice from his accountant throughout. The first loan dated back to 1979. None of the transactions themselves were regulated agreements under the Consumer Credit Act 1974. Asset finance providers in the UK will need to wake up to the fact that these claims could affect business which is not regulated by the CCA and amend the internal processes to deal with this.

This is a High Court case so County Courts should follow it. Asset finance providers will find that these unfair relationship cases could crop up anywhere –not just in court actions to recover money, assets or land – but in divorce proceedings too.

The last payment made was in November 2001. The lender was criticized by the Judge for allowing things to roll along – knowing that interest would accrue and that he could claim against the borrower's estate if he died.

The borrower had a profitable Londis business, his own mortgage-free home and a portfolio of buy-to-let properties. However, if the lender had taken a firmer stance on recovery action earlier would this too have back-fired on the lender?

A double-edged sword

Asset finance providers seem to face a double-edge sword on this. This is not satisfactory and when a case does eventually reach the Court of Appeal – it will need to nail its colours to the mast.

The Judge found the borrower to have repeatedly lied on oath to the court. The Judge believed the lender (he called him an "astute and hard-headed businessman") more than he believed the borrower. Yet despite this, the Judge still made a finding that there was an unfair relationship finding which ruling was adverse to the truthful lender.

So asset finance providers who seek to discredit defaulting borrowers - who in court actions to recover debts or assets raise an unfair relationship defence - may be wasting their time and their breath.

Although unfair relationships do not apply to consumer hire or leasing arrangements, UK based asset finance providers will face these claims in relation to hire purchase or loan facilities. There is no financial limit – as long as the customer is an unincorporated sole trader. The fact that the finance is for business purposes is irrelevant as this case clearly shows.

The Judge in this case did not refer to any of the other eight cases where "unfair relationships" have been considered by other courts. The Judgment is liable to be attacked on this point when a case does eventually reach the court of appeal – but this may not be fatal if the appeal court says it would have made no difference to its ruling anyway.

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