Consumer Credit: the Narrowing of "Linked Transactions" in relation to the Total Charge for Credit

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In a recent article in this Journal, Sheila Bone and Leslie Rutherford drew attention to the way the Consumer Credit (Linked Transactions) (Exemptions) Regulations 1983 narrow the intended ambit of the concept of the "linked transaction" in consumer credit control. {"Consumer Credit, Defects in the Linked Transactions Regulations", [1985] J.B.L. 209.} Their analysis concerned cancellation and early settlement. This article looks at another area, namely the calculation of the total charge for credit. In particular it considers the effect of the narrowing in this area of the linked transaction concept on the ability of certain types of moneylender to escape regulation by the Consumer Credit Act 1974.

The total charge for credit

The total charge for credit is arrived at under the Consumer Credit (Total Charge for Credit) Regulations 1980 as amended. By virtue of the definition of "transaction" in regulation 1, charges payable under either of the following are to be included:-

A. A "linked transaction" entered into with any other person in compliance with a term of the credit agreement.

B. Any other contract to which the debtor or a relative of his is a party and which the creditor requires to be made or maintained as a condition of the making of the credit agreement.

{It is immaterial that full value may be given in return for payments made under either type of transaction.}

The first of these (which I will call a "class A transaction") exactly corresponds to a part of the definition of "linked transaction" given by the Act, namely that contained in section 19(1)(a). The narrowing of the Act's concept of the linked transaction lies in the fact that the second type (a "class B transaction") is all that the regulations leave of the remainder of the Act's definition. For understandable reasons, they omit altogether section 19(1)(b), which renders a transaction a "linked transaction" if it is financed by a three-party debtor- creditor-supplier agreement. Less understandably, they reduce to the form expressed by class B the very much wider statement encapsulated in section 19(1)(c) and (2).

This latter type of contract covered by the Act's definition of "linked transaction" is typically one between the debtor and the creditor or its associated company. It may well be a contract which, in the words of section 19(1)(c), the creditor "initiated ... by suggesting it to the debtor ... who enters into it ... for [a] purpose related to the principal agreement". I will refer to a contract of this kind as a "class C transaction".

The low-interest exemption

The Consumer Credit Act provides a number of exemptions from regulation, even where the credit agreement does not exceed the current limit of #15,000 and is made with an "individual". {A debtor other than an "individual" is not protected by the Act.}

In addition to its ordinary legal meaning of one or more natural persons, section 189(1) of the Act defines

"individual" as including a partnership or other unincorporated body of persons not consisting entirely of bodies corporate. This means that while a body such as a trade union, friendly society, or unincorporated club would be within the intended protection of the Act, a registered industrial and provident society would not. {By virtue of ss. 3 and 74 of the Industrial and Provident Societies Act 1965, a society registered or deemed to be registered under that Act is by virtue of its registration a body corporate with limited liability.}

The gap in protection caused by not including sums payable under all class C transactions in the total charge for credit is illustrated by what may be called the low-interest exemption.

Section 16(5)(b) of the Consumer Credit Act empowers the Secretary of State to make an order providing that the Act shall not regulate consumer credit agreements where the rate of the total charge for credit does not exceed the rate specified in that behalf in the order. The current order is the Consumer Credit (Exempt Agreements) (No. 2) Order 1985 as amended, article 4 of which confers the low-interest exemption.

This exemption takes two alternative forms so far as it relates to moneylending transactions, called by the Act debtor-creditor agreements. {Section 13 of the Consumer Credit Act 1974 defines a "debtor-creditor agreement" as an agreement of one of three types. A cash loan is normally of the third type, described in s. 13(c): "an unrestricted-use credit agreement which is not made by the creditor under pre-existing arrangements between himself and a person ("the supplier") other than the debtor in the knowledge that the credit is to be used to finance a transaction between the debtor and the supplier".} These are respectively laid down by article 4(1)(a) and article 4(1)(c), either of which may be applicable.

Article 4(1)(a) exempts a debtor-creditor agreement in respect of which the rate of the total charge for credit, i.e. the annual percentage rate or APR determined to one decimal place, does not exceed the latest "specified rate" prevailing on the date 28 days before the date on which the agreement is made. Article 4(1)(c) exempts a debtor-creditor agreement in respect of which the only amount included in the total charge for credit is interest in respect of which the APR cannot under the agreement at any time exceed the latest specified rate prevailing on the date 28 days before that time.

The specified rate, effectively the maximum rate for claiming exemption, is the higher of the following:-

(a) the rate of 13 per cent per annum;

(b) the sum of one per cent per annum and the highest of any base rates published by twelve named banks, including the Bank of England and the "big four" (Barclays, Lloyds, Midland and NationalWestminster).

If, as would normally be the case apart from the question of linked transactions, the only item entering into the total charge for credit under a moneylending agreement is interest, the only effective difference between the article 4(1)(a) exemption and the article 4(1)(c) exemption is that the former operates by reference to base rates prevailing 28 days before the loan agreement is made, while the latter operates by reference to base rates prevailing at any time during the currency of the loan. If the loan period is lengthy, the article 4(1)(c) exemption is clearly preferable as offering the lender protection against a big increase in prevailing interest rates.

Nevertheless it will be seen that with the ordinary cash loan the commercial rate of interest is likely to be too high to enable the lender to obtain exemption. This may not however be the case where interest is not the only reward sought.

Trading companies sometimes find it profitable to lend money at a low rate of interest in order to tie the debtor, during the repayment period, to some kind of recurring commercial transaction. Because of the width of the Act's definition of "individual" many transactions of this kind are, as they were intended to be, within the range of its protection. {The form of a loan transaction, e.g. whether or not it is under seal or comprises a land mortgage, guarantee, or other security, is in general immaterial on the question of whether

it is regulated by the Act, which looks to the substance.}

Take for example the brewery company which wishes to bind a local working men's club to purchase its own products for sale in the club bar to the exclusion of those of its competitors. The club perhaps needs a loan to improve its premises, and the brewery is happy to oblige. The interest is well below the exemption rate, but profits from liquor sales amply compensate. There are many such agreements up and down the country.

For the creditor to have to comply with the documentation and other requirements of the Act in such cases is inconvenient, and may well reduce profits. It is preferable to seek exemption, and this is where we see the difference between adding any class C charges to the total charge for credit and being content, as the current regulations are, with class B.

Either will apply if the loan agreement follows the hitherto usual course and includes a bald requirement to obtain liquor supplies exclusively from say the nominee of the creditor (who will of course be an associated company). But this is not the only way to do it. It will suffice to impose a rate of interest just below the exemption level, coupled with a much lower rate (and possible writing off of part of the loan principal) so long as liquor requirements are obtained exclusively from the creditor or its nominee. This may be backed up by a term entitling the creditor to call in the loan at any time (it being made known informally that this will not be done so long as liquor purchases are maintained).

Such an arrangement would be caught if charges under all class C transactions were included in the total charge for credit. Each contract entered into by the club for liquor supplies could properly be described as initiated by the creditor, since it was prompted by a term in the loan agreement. Clearly, for the same reason, the creditor would be taken as having suggested it to the debtor. The purpose for which it was entered into relates to the loan agreement, since it ensures a lower interest charge under that agreement and possible writing-off of principal.

All that is in accordance with the carefully thought out plan of the Act. Yet the regulations, for no discernible reason, depart from this. They fail to bring in such a contract. It is not a class A transaction because it is not made "in conformity with" a term of the loan agreement, which leaves the debtor legally free to choose his liquor supplier.

Nor is it within class B. The creditor does not require it to be "made or maintained". All he says is that if it is made the rate of interest under the loan agreement, and possibly other conditions, will be more advantageous to the debtor.

The regulations seek to be wiser than the Act. In doing so they reduce the ambit of its protection. This may be thought unjustified, since the Act was debated and passed by Parliament while the regulations of course were not.

A drafting defect in the Act

In conclusion it should perhaps be pointed out that the Consumer Credit Act's definition of "linked transaction" suffers from a drafting defect which might be thought to bear upon the matters discussed above. Section 19(1) describes the agreement to which a transaction is linked as "an actual or prospective regulated agreement". Yet as we have seen the very question whether an agreement is regulated may turn on whether or not charges under the other transaction are or are not to be included in the total charge for credit. In the class A case, this in turn depends on whether the transaction is within this definition.

Example:

Facts D, an unincorporated sports club, enters into a low- interest personal credit agreement with C, a supplier of sports equipment. In compliance with a term of the agreement requiring D to purchase its

requirements from C, D then enters into successive purchasing contracts with C. If the interest only is treated as a credit charge, the personal credit agreement will be exempt under the low-interest exemption. If the charges under the purchasing contracts are treated as part of the total charge for credit the exemption will not apply and the credit agreement will be a regulated agreement.

Analysis The charges are to be brought in if the purchasing contracts under which they are made are "linked transactions". However s. 19(1) says they are only such if made in relation to a regulated agreement. But the question whether the credit agreement is regulated depends on whether or not the charges are brought in. There is thus circularity of reasoning.

It is submitted that the definition should be applied as if for the reference to a regulated agreement or a prospective regulated agreement there were substituted a reference to an actual or prospective personal credit agreement or consumer hire agreement. This accords with the original policy underlying the concept of the linked transaction. {See Report of the Committee on Consumer Credit (the Crowther Report) Cmnd. 4596, Vol. 1, chap. 6.9, extracts from which are set out in Bennion, Consumer Credit Control Vol. 1, pp. 1109-1112.} Such a construction also complies with the principle ut res magis valeat quam pereat which applies to the construction of Acts. {See Bennion, Statutory Interpretation s 123.}

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