Clients&FriendsMemo

Broker dealer commissions: UK Supreme Court hears appeal in *Johnson, Wrench, Hopcraft v Close Bros. and FirstRand*

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Executive Summary

- The UK Supreme Court last week heard arguments in the joined test cases of *Johnson v FirstRand Bank Ltd, Wrench v FirstRand Bank Ltd and Hopcraft v Close Brothers Ltd.* At issue were findings by the Court of Appeal that: (i) a car dealer also acting as credit broker may well owe a fiduciary duty to their customer, (ii) in the absence of full disclosure of the amount and nature of commission paid by the lender to the broker, the lender could be liable to the customer for the sum of commission paid, (iii) this amount could be claimed regardless of the level of loss actually suffered by the customer, and (iv) customers could also rescind the contract with the lender as of right – thereby recovering interest paid under the agreement, subject to counter-restitution for the benefits received under the contract.

- This cut across established lending practices based on the existing financial regulatory regime. The Treasury sought (unsuccessfully) to intervene in the case, and even consumer finance advocates expressed concerns that the Court of Appeal decision risked doing more harm than good.

- The legal issues are complex, and without clear precedent. The Supreme Court's findings as to lender liability consequent to the existence of a fiduciary duty owed by a broker dealer to their customer, in the context of an otherwise arm's-length transaction, will have significant implications for the consumer lending market as a whole, as well as financing and commercial transactions more broadly.

- Questions from the Supreme Court to counsel during the recent hearing provide some indications as to the conclusions that the court may draw. Firms expecting to be most affected by the forthcoming judgment may be assisted by considering the Supreme Court's interventions, and subsequent exchanges, in more detail.

- The Supreme Court has indicated that its judgment will be handed down in July 2025 at the earliest.

Background

Johnson, Wrench and Hopcraft each purchased a car on finance arranged by a car dealership. Their evidence was that they were unaware that the dealerships would receive commission for having arranged the finance. In *Hopcraft* it was accepted that there had been no disclosure of the commission. In *Wrench* and *Johnson*, the relevant contractual documentation stated that commission *may* be payable.

The Court of Appeal considered that in each case there had been inadequate disclosure of the commission. It held that in the *Wrench* and *Johnson* cases the commission was "fully secret". Whatever was in the contracts, the customers did not know, and had not been told about the commission. It found that in *Hopcraft* the commission arrangements had not been sufficiently disclosed by the lender. The Court of Appeal rested its conclusions on the nature of the relationship between the dealers and the customers, which it found was fiduciary. A fiduciary owes single-minded loyalty to their principal, and may not profit from that relationship without the principal's fully informed consent. The Court of Appeal held that the payment of commission to the dealer introduced a conflict of interest which could be overcome only by disclosure of the commission arrangements in the most clear and prominent terms.

For the underlying lenders, the consequences were significant, and included:

i. liability as primary wrongdoer for the "secret payments" made in *Hopcraft* and *Wrench*, meaning the claimant was entitled to the full amount of the commission without any adjustment to reflect their actual loss, as well as rescission of the contract (subject to the possibility of counter-restitution); and

ii. accessory liability for having assisted the broker's breach of fiduciary duty, by paying commission to the brokers. This entitled the claimant to equitable compensation for loss, taken to be the amount of the bribe, unless evidence proved otherwise, and the ability to request (at the discretion of the court) that the contract be rescinded.

The Court of Appeal found that it would be no defence for an underlying lender to plead that it (or the regulator) had required the dealer to make full disclosure, if that had not happened: "*If the lender does not take it upon itself to give full disclosure to the consumer, it deliberately takes the risk that the broker will not do so…*"

These findings did not reflect the settled understanding of market participants as to the nature of the relationship between a car dealer brokering finance and the customer. They also appeared to exceed regulatory requirements, with lenders understandably objecting that from a consumer protection perspective the goalposts had moved. The government expressed concern at the effect of the judgment on the stability of the motor finance industry and unsuccessfully applied to participate as an intervener in the Supreme Court hearings, whilst even consumer finance advocates sounded notes of caution at the effect such requirements could have on the willingness of lenders to provide car finance to consumers.

Following the Court of Appeal judgment, the volume of consumer claims ballooned, facilitated by claims management firms attracted by the prospect of sizeable claims, without the need to adduce evidence as to the exact loss suffered by the customer. Notably in *Johnson*, the amount of commission paid to the broker was 55% of the sale price of the car.

The key issues argued before the Supreme Court

Against this backdrop, key issues argued before the Supreme Court included:

- whether the brokers in *Hopcraft*, *Wrench* and *Johnson* were in fact fiduciaries, and whether alternatively they had a lesser "disinterested duty" to provide advice, information, or a recommendation on an impartial basis. The appellants argued that the car dealer's obvious financial interest in the sale of the car was incompatible with the finding of such duties, and that there was no point at which the brokers had clearly undertaken duties of this nature. The Appellants made the memorable argument that whilst brokers may have said they would secure a rate of interest that was competitive or suitable for the customer's needs, that no more carried duties of loyalty than an assertion by a sommelier that they would provide a customer with the wine most suitable to their taste.

- if such duties do exist, whether the lenders' level of knowledge made them "dishonest", as required for the lenders to be liable as accessories to the broker dealers' breaches of duty. The Respondents' position was that the lenders' mere knowledge that the car dealer was acting as credit broker was sufficient, whilst the lenders argued that dishonesty required knowledge that the dealer owed a fiduciary duty.

- whether insufficient disclosure of the commissions resulted in a situation in which the relationship between the customer and the lender was "unfair" within the meaning of the Consumer Credit Act 1974, which includes unfairness arising from anything done or not done on behalf of the creditor. The Appellants argued that this issue should be remitted to the lower courts, with the respondents arguing that failure to fully disclose the amount of the commission unfairly deprived the customer of the opportunity to make an informed decision as to whether to enter into the credit agreement.

- the Appellants submitted that the Court should reconsider the remedies for secret payments, in particular the recovery of the full amount of the commission – which the appellants argued reflected an incorrect understanding or flawed development of the law.

The FCA's submissions

The Financial Conduct Authority appeared as interveners (i.e. interested third parties) and gave submissions that will be of interest to market participants. As regards the relationship between

private law rights/remedies and the FCA regulatory regime, the FCA argued that whilst the latter did not exclude the Court's jurisdiction in this area, it should nonetheless be taken into account by the Supreme Court in reaching its decision.

The FCA's submissions also included: (i) that FCA regulations did not presume that regulated firms owed fiduciary duties, (ii) that the standards of disclosure contained in the Consumer Credit Sourcebook ("CONC") were less exacting than those required by the Court of Appeal's judgment, (iii) that whilst lenders bore some responsibility for the conduct of brokers, the FCA and statutory schemes did not treat the lender as a primary wrongdoer, and (iv) that the current regulatory framework was well-balanced.

As to any duty owed by the broker to the customer, the FCA supported a third way, with broker dealers typically owing a "disinterested duty" as referred to by the Court of Appeal, but not fiduciary duties. The FCA seemingly based this conclusion on the need for private law remedies for conflicts of interest that were consistent with the obligations of broker dealers to manage conflicts of interest fairly (Principle 8 in the FCA Handbook), and to deliver good outcomes for retail customers (Principle 12). However, the Appellants objected that any disinterested duty would in practice have to collapse into a finding of a fiduciary duty, if the court were to award the remedies sought. Firms interested in the most likely scope of any FCA redress scheme may wish to examine the FCA's written submissions in full. We are very happy to discuss this in further detail.

Impact of the Supreme Court's decision

The implications of the Supreme Court's ruling are of particular importance to the motor finance and consumer lending sectors, especially where the broker was also the seller of a good or service being purchased with the finance. As the Court of Appeal noted, the services provided in *Hopcraft*, *Wrench* and *Johnson* were "*materially the same as that provided by other credit brokers of consumer finance*".

Market participants wishing to prepare for the Supreme Court's judgment (expected July 2025 at the earliest) do not have a simple task. Whilst we have a view of where the Court is coming out on a number of the points argued, the application of the Supreme Court's decision will inevitably be both nuanced and fact sensitive. It is unlikely for example that the Supreme Court would determine that there are no circumstances in which a car dealer could be found to have fiduciary duties to the customer. It will be a question of degree. Moreover, various interventions by the Justices in last week's hearing suggest that if the Court of Appeal's decision is upheld, it may be on the basis of materially different reasoning.

The ruling is also of significance to the FCA's ongoing review of historical motor finance discretionary commission arrangements, which it commenced in January 2024, and any redress scheme which it might impose. The FCA has acknowledged that its approach to a redress scheme will be dependent on the findings of the Supreme Court. That is, in part, because before the FCA can propose any redress scheme, it is required to consider other causes of

action available to consumers (e.g. private law claims), and have regard to the type and amount of relief that a court would award. The FCA has stated it will confirm within six weeks of the Supreme Court's decision if it plans to implement a redress scheme. It has already announced that any suggested redress scheme would require firms within scope to proactively identify customers that may have suffered loss, and approach them with an offer of compensation.

We would be very happy to discuss the recent hearing and how these issues may impact your business. Please feel free to contact any of the following Cadwalader attorneys:

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