LENDER LIABILITY
after
MORLEY V RBS

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The litigation

- Trial: Morley v RBS [2020] EWHC 88 (Ch) Kerr J
- Court of Appeal: ([2021] EWCA Civ 338 Males, Birss and Lewison LLJ
- SC?

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Outline of talk

- Scope of regulation of secured lending (JV)
- Summary of facts in Morley v RBS (JV)
- Claims advanced: (a) intimidation; (b) duress and (c) breach of duty to exercise skill and care/act in good faith when exercising powers (HS)
- Lender duties qua mortgagee (JV)
- Concluding remarks (HS)

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Scope of regulation of secured lending (1)

- Historically – commercial and residential lending was unregulated so that lender liability for imprudent lending relied on establishing a duty of care in relation to product suitability e.g. *Verity v Lloyds Bank* 1995 CLC 1557
- 31 October 2004 – RMC taken into regulatory control in relation to loans to an individual secured over land in the EEA where at least 40% was intended to be used as a dwelling: Art 61 of RAO
- Some protection therefore for mixed residential / commercial loans

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Scope of regulation of secured lending (2)

- Protection created by MCOB Rules which operate at 2 levels by imposing duties in relation to:
  - Product selection
  - Exercise of lender enforcement powers
- As regards – product selection: MCOB 4.7.2R imposes an obligation to ensure the mortgage is suitable for the customer i.e. that it is affordable, appropriate to the needs and circumstances of the customer and the most suitable product to which the adviser has access
- As regards – enforcement powers?

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Scope of regulation of secured lending (3)

MCOB13.3.4AR requires the mortgagee to: "(1) …consider whether, given the individual circumstances of the customer, it is appropriate to do one or more of the following in relation to the regulated mortgage contract … with the agreement of the customer: (a) extend its term; or (b) change its type; or (c) defer payment of interest due on the regulated mortgage contract or of sums due under the home purchase plan (including, in either case, on any sale shortfall); or (d) treat the payment shortfall as if it was part of the original amount provided (but a firm must not automatically capitalise a payment shortfall where the impact would be material); or (e) make use of any Government forbearance initiatives in which the firm chooses to participate…".

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Morley – summary of facts (1)

- Commercial loan – Fixed term loan granted December 2006 for £75m secured over a property portfolio in north of England worth c£95m; no borrower recourse and facility part-hedged (£49m); lending rate 1% over base
- Fall in interest rates led RBS to press Morley to re-base loan to LIBOR and re-hedge entire borrowing – Morley refused – in RBS interests not those of Morley as borrower
- January 2009 RBS obtains a desk top revaluation down valuing portfolio to £59m – impact on LTV covenant (breach)
- July 2009 – transferred to GRG: "borrower is toast"
- RBS decides to await loan expiry but recognises:
  - (a) loan being serviced
  - (b) asset values will recover

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Morley – summary of facts (2)

- December 2009 loan expires – RBS/GRG does not exercise right to appoint receivers but pursues negotiations with Morley as to terms to refinance the debt and undo the non-recourse nature of the debt (£75m now held against a portfolio worth £59m)
- Negotiations then turn to Morley buying back the portfolio – logically anything >£59m should represent maximum recovery
- Pressure from APA for RBS to acquire portfolio via its wholly owned subsidiary: West Register

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Morley – summary of facts (3)

- Negotiations culminate in RBS threatening Morley that if he will not consensually transfer portfolio to West Register, RBS will appoint LPA receivers and effect a transfer the transfer in any event
- Morley is partially successful in resisting the threat by agreeing to surrender c75% of the portfolio to RBS/West Register and buy back c£25%
- In losing most of the portfolio, Morley lost (a) income stream and (b) chance of capital appreciation
- What claims does this history suggest?

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The claims advanced (1)

Morley advanced 3 basic claims which raise significant questions as to the boundaries of:

- The tort of intimidation
- The tort (?) of economic duress
- The existence and scope of any duty to exercise skill and care and/or to act in good faith when a lender is negotiating with a borrower in default and/or in deciding on the exercise of pre-enforcement powers as mortgagee

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The claims advanced (2): Tort of intimidation

- *Rookes v Barnard* [1964] AC 1129 identified the following key ingredient:
  - A threat by the defendant to do something independently unlawful
  - The threat must be intended to coerce the claimant to take or refrain from taking some course of action
  - The threat must in fact coerce the claimant to take such action
  - Loss or damage must be incurred by the claimant as a result
- But: does the boundary of the claim now extend to a threat to do something which is "illegitimate" and not otherwise independently unlawful? Assumed – yes in *Berezovsky v Abramovic* [2011] EWCA Civ 153
- Relevant to Morley if RBS threat was not per se unlawful

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The claims advanced (3): Tort of intimidation

- So, how did the matter rest following…
- Kerr J at first instance?
- In the Court of Appeal?

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The claims advanced (4): Tort of economic duress (a)

- First, the law distinguishes between cases entailing an illegitimate demand backed by a threat to commit an unlawful act and cases where the threatened act falls short of being illegal but is nonetheless "illegitimate" in the sense that it is a threat to do something that is "morally and socially unacceptable": *CTN Cash & Carry v Gallagher* [1994] 4 AER 714
- Relevant to Morley if RBS threat was not unlawful
- Secondly, where the threat is not one to commit an unlawful act, but an illegitimate act, the demand may only be illegitimate if made in bad faith: *Times Travel UL Ltd v Pakistan International Airlines Corp* [2019] EWCA Civ 828 (SC decision awaited)

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The claims advanced (5): Tort of economic duress (a)

It remains an open question whether economic duress is a tort:

- Lords Diplock and Scarman expressed differing views in *Universe Tankships of Moravia v I.T.W.F.* [1983] AC 366 [AB3/40/1449] – See Lord Diplock at p385B – not tort per se; Lord Scarman's views at p400B – is actionable as a tort
- Left open in *Investec Bank (Channel Islands) Ltd v Retail Group plc* [2009] EWHC 476 Ch per Sales J at [122]; *Al-Neheyan v Kent* [2018] EWHC 333, per Leggatt LJ and Nugee J in *Holyoake v Candy* [2017] EWHC 3397
- If not a tort, then the only remedy is rescission (if available) or the ingredients of the tort of intimidation will need to be established

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The claims advanced (6): Tort of economic duress (a)

Where did the matter rest….

- At first, following the judgment of Kerr J?
- And, following the Court of Appeal?

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The claims advanced (7): Breach of implied term

- The lending contract is a contract to provide a service so that s13 of the Supply of Goods and Services Act is engaged & Hedley Byrne
- As the lending contract was “continued” whilst negotiations were being pursued by RBS as to refinance terms then a duty should be recognised obliging RBS to exercise care and skill in proposing terms/ deciding whether and how to enforce
- Restructuring services & viability assessments - the GRG Manual required RBS to undertake a financial viability assessment and consider if default was caused by extraneous events (as here)
- The debt was still serviceable on reasonable economic terms and asset value improvement over time was expected
- Duty demanded:
  - refinance on commercial terms or
  - portfolio buyout at market value

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The claims advanced (8): Breach of implied term

- So, where were we left…
- Following Kerr J at first instance, and
- By the Court of Appeal?
- SC?

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The claims advanced (9): Breach of good faith duty

In *Property Alliance Group Ltd v RBS* [2018] EWCA Civ 355 the court recognised a lender duty in the following terms applicable to the exercise of a power: "to be exercised in pursuit of legitimate commercial aims rather than, say, to vex [the borrower] maliciously… [and not] for a purpose unrelated to its legitimate commercial interests or if doing so could not rationally be thought to advance them"

In Morley the issue was as to whether in RBS had made decisions "qua buyer" of the portfolio rather than "qua lender" – the issue was left unaddressed by the Court of Appeal in light of its conclusion as to what was found at first instance

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The claims advanced (10):Breach of good faith duty

So, where were left:

- Following Kerr J at first instance?
- And after the Court of Appeal?
- SC?

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Lender duties qua mortgagee (1) – Sale to self

- A mortgagee is not entitled to "buy" the asset held as security as (a) it cannot "sell" to itself and (b) there is a conflict of interest in fixing the price but can sell to a subsidiary or company in which it has an interest: *Farrar v Farrars Ltd* [1880] 40 Ch D 394 and *Tse Kwong Lam v Wong Chit Sen* [1983] 1 WLR 1349
- But: properly understood neither case should permit a sale by a mortgagee to a wholly owned subsidiary
- The facts are important…

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Lender duties qua mortgagee (2) – Sale to self

- In Farrar the mortgagors agreed the quarries in charge could be sold to a company if found/formed provided the price was not less than £7,700 and that the agreement was made in November. December 1885; after that agreement was reached, Farrar decided to take shares in the company which he did in or about February 1886 Chitty found that the original agreement was honestly concluded and that "the terms were not in any degree affected by the circumstance that ...John Riley Farrar subsequently agreed to become a member of ...the company" that bought the quarries. There was a finding that when Farrar agreed the original deal "at this time ...he had no conflicting interest in the matter"

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Lender duties qua mortgagee (3) – Sale to self

- The conclusion of the court was not just that Farrar had behaved properly throughout and the mortgagees' burden of sustaining a transaction that looked suspicious had been discharged but wrapped up in that is the vital point that Farrar's interest as shareholder in the acquiring company post-dated the agreement to sell at £7.7k
- Had that not been the case and the transaction had entailed a sale to a company in which one of the mortgagees had a material interest then the court was (surely) saying it would have been set aside automatically: Thus: "the sale could not have stood ... if when the agreement for sale was made Mr Farrar had been... indirectly one of the buyers. His subsequent conduct does not invalidate the sale then agreed to and afterwards carried out" and "Mr Farrar was not a trustee selling to himself ...nor was he buying indirectly for himself"

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Lender duties qua mortgagee (4) – Sale to self

- In *Tse Kwong* counsel for the mortgagee submitted that a mortgagee could sell to a company in which it had an interest subject to satisfying the court that it took reasonable steps to achieve market value – this was a "submission" only
- counsel for the borrower then submitted that a mortgagee could not sell to his solicitor or agent for the obvious reason there was a conflict of interest in the agent obtaining the lowest price and the mortgagee having a duty to maximise price but "admits there can be no general duty that a company in which a mortgagee is interested cannot purchase the mortgaged property" – that was a concession - there then follows citations from *Farrar*
- This leads to the PC then stating: "It is the view of this Board on authority and on principle there is no hard and fast rule that a mortgagee may not sell to a company in which he is interested"
- This conclusion appears to rest on shaky foundations in that (1) the basis is a possible misreading of *Farrar* and (2) the principle makes no sense in light of the concern over conflicted interests – at least in the case of a wholly owned subsidiary

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Lender duties qua mortgagee (5) Purity of purpose

- It is said that so long as "a reason" for a mortgagee enforcing its security is to obtain repayment it does not matter if it is enforcing for any other ulterior purpose: *Cukurova Finance* [2016] AC 923

- But: (1) *Cukurova* was a special case on its facts and (2) the SC has left open the need for "purity of purpose" when a power is being exercised in a contractual and not "mortgagee" setting: *Eclairs Group Ltd v JKX & Gas plc and others* [2015] Bus LR 1395

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Concluding remarks

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