DRN-4087602

Financial Ombudsman Service

The complaint

Mr B complains that Lloyds Bank Plc treated him unfairly when it didn't get his money back for an engagement ring he bought.

What happened

In November 2019 Mr B paid £751 for an engagement ring using his Lloyds credit card, from a shop I will call 'Firm A' at their premises. In January 2020 Mr B took the ring back to the same premises to be resized and discovered that Firm B had taken over the shop as Firm A had ceased trading. Firm B then resized the ring for Mr B. In January 2021 Mr B noticed one of the prongs / claws that held the stones (diamond and sapphire) had snapped off on both sides of the three stone engagement ring. So he took it to the shop premises and Firm B said the issues with the claws were nothing to do with them and he should speak to Firm A. Mr B says he researched Firm A and found it had gone into liquidation. So he took this issue to Lloyds.

Lloyds considered the matter and noted that Mr B raised the issue to it over 120 days after receiving the ring. So it didn't think a Chargeback had a reasonable prospect of success. It also considered a claim under Section 75 of the Consumer Credit Act 1974. It decided that the necessary relationship set out in the Act was not in place for S75 to apply. So it said it couldn't be liable for any claim. And hence it didn't consider any further whether the ring was of satisfactory quality. Mr B felt that this was unfair, so he brought his complaint to this service. Our Investigator looked into the matter and agreed with Lloyds that the necessary relationship wasn't in place for Lloyds to be liable under the legislation I've described.

Mr B didn't agree and pointed to case law and decisions by this service. So this complaint came to me to decide. I issued a provisional decision on the matter dated 03 April 2023 which upheld Mr B's complaint. Both parties have responded to it.

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

Both parties accepted my findings. Lloyds confirmed it would redress the matter as I'd set out in my provisional decision. Mr B confirmed he accepted the provisional decision and redress methodology I'd set out. Accordingly I see no reason to deviate from that position as set out in my provisional decision and so Mr B's complaint is successful. I shall now set out my rationale from my provisional decision here which is given between the headings of "authorisation" through to the heading of "summary".

authorisation

Mr B accepts he made the transaction for the engagement ring. He doesn't dispute the amount charged or the date it was charged. And it hasn't been argued that it was double charged or applied to the wrong account. Considering what has happened here and what the

parties have said, I'm satisfied on balance that Mr B did properly authorise the transaction at the time. And accordingly it was correctly allocated to his account by Lloyds.

could Lloyds challenge the transaction through a chargeback?

In certain circumstances, when a cardholder has a dispute about a transaction, as Mr B does here, Lloyds (as the card issuer) can attempt to go through a chargeback process. I don't think Lloyds could've challenged the payment on the basis Mr B didn't properly authorise the transaction, given the conclusions on this issue that I've already set out.

Lloyds has said that it couldn't raise a chargeback request due to the time constraints within the network rules and due to the time between when Mr B paid for the ring and when he took his dispute to Lloyds. I've looked into what happened here and considered the network rules around chargeback and agree it was out of time. Accordingly I don't think Mr B has lost out here by Lloyds not raising a chargeback.

Section 75

Here I must consider what Lloyds should do. To do this, I have to decide what I think is fair and reasonable, having regard to, amongst other things, any relevant law including both legislation and case law. In this case, the relevant starting point is S75 of the Consumer Credit Act 1974 (the "Act") which says that, in certain circumstances, if Mr B paid for goods or services on his credit card and there was a breach of contract or misrepresentation by the Supplier, Lloyds can be held responsible.

For clarity's sake I shall explain the underpinning legislation concerning the DCS concept before explaining my thinking on this case. S75(1) states:
"If the debtor under a debtor-creditor-supplier agreement falling within section 12(b) or (c) has, in relation to a transaction financed by the agreement, any claim against the supplier in respect of a misrepresentation or breach of contract, he shall have a like claim against the creditor, who, with the supplier, shall accordingly be jointly and severally liable to the debtor."

So s.75 only applies if:

i) There is a debtor-creditor-supplier agreement (or "DCS" agreement, for short) of the type that falls within s.12(b) or (c);
ii) That agreement finances the transaction between the debtor (Mr B) and the supplier (Firm A); and,
iii) If, relating to that transaction, the debtor (Mr B) has a claim against the supplier (Firm A) in respect of a misrepresentation or breach of contract. If so, then the creditor (Lloyds) is jointly and severally liable to the debtor.

S.12(b) applies to:
"a restricted use credit agreement which falls within section 11(1)(b) and is made by the creditor under pre-existing arrangements, or in contemplation of future arrangements, between himself and the supplier"
S.11(1)(b) defines a restricted-use credit agreement as a regulated consumer credit agreement:
"to finance a transaction between the debtor and a person (the "supplier") other than the creditor"
Subsections 11(3) & (4) provide:
"(3) An agreement does not fall within subsection (1) if the credit is in fact provided in such a way as to leave the debtor free to use it as he chooses, even though certain uses would contravene that or any other agreement.

(4) An agreement may fall within subsection (1)(b) although the identity of the supplier is unknown at the time the agreement is made."
Section 187 provides:
"(1) A consumer credit agreement shall be treated as entered into under pre-existing arrangements between a creditor and a supplier if it is entered into in accordance with, or in furtherance of, arrangements previously made between persons mentioned in subsection (4)(a), (b) or (c).
(2) A consumer credit agreement shall be treated as entered into in contemplation of future arrangements between a creditor and a supplier if it is entered into in the expectation that arrangements will subsequently be made between persons mentioned in subsection (4)(a), (b) or (c) for the supply of cash, goods and services (or any of them) to be financed by the consumer credit agreement.
(3) Arrangements shall be disregarded for the purposes of subsection (1) or (2) if—
(a) they are arrangements for the making, in specified circumstances, of payments to the supplier by the creditor, and
(b) the creditor holds himself out as willing to make, in such circumstances, payments of the kind to suppliers generally.
(4) The persons referred to in subsections (1) and (2) are—
(a) the creditor and the supplier;
And s.189 says *"finance"* means to wholly or partly finance, and that *"financed"* shall be construed accordingly.
Historically credit cards worked within a commonplace three-party structure. Specifically that there was:

- an agreement between the card issuer (the Creditor) and the cardholder (the Debtor) to extend credit by paying for goods or services purchased by the cardholder from suppliers who had agreed to honour the card;
- an agreement between the card issuer and the Supplier under which the Supplier agreed to accept the card in payment and the card issuer agreed to pay the Supplier promptly;
- an agreement between the cardholder and the Supplier for the purchase of goods or services.

As time went by a new type of party entered the market and specifically these types of transactions, known as the 'Merchant Acquirer'. This led to the creation of four party relationships where instead of the agreement being between the card issuer and the supplier, there were two agreements:

- an agreement between the merchant acquirer and the supplier, under which the supplier undertook to honour the card and the merchant acquirer undertook to pay the supplier; and
- an agreement between the merchant acquirer and the card issuer, under which the merchant acquirer agreed to pay the supplier and the card issuer undertook to reimburse the merchant acquirer.

The impact of this development on the application of S75 was considered by the Court of Appeal in the case of Office of Fair Trading v Lloyds & others [2006] ("the OFT case"). The Court of Appeal first considered whether the introduction of the four-party structure meant that the system had evolved significantly beyond the state of affairs to which S75 had been directed. They concluded that it had not, stating at paragraph 55 of their judgment:

"*From the customer's point of view … it is difficult to see any justification for drawing a distinction between the different [three-party and four-party] situations. Indeed, in the case of those card issuers such as Lloyds TSB, who operate under both three-party and four-party structures, the customer has no means of knowing whether any given transaction is conducted under one or other arrangement. Similarly, from the point of view of the card*

issuer and the supplier the commercial nature of the relationship is essentially the same: each benefits from the involvement of the other in a way that makes it possible to regard them as involved in something akin to a joint venture, just as much as in the case of the three-party structure."

They went on to say;

"*It is clear that, whether the transaction is entered into under a three-party or four-party structure, the purpose of the credit agreement is to provide the customer with the means to pay for goods or services. It follows that in both cases the card issuer finances the transaction between the customer and the supplier by making credit available at the point of purchase in accordance with the credit agreement. The fact that it does so through the medium of an agreement with the merchant acquirer does not detract from that because it is the card issuer's agreement to provide credit to the customer that provides the financial basis for the transaction with the supplier*."

In the House of Lords in the same case Lord Mance said, in relation to the recruitment of overseas suppliers to the network:
30. That, in today's market, arrangements between card issuers and overseas suppliers under schemes such as VISA and MasterCard are indirect (rather than pursuant to a direct contract as is still the case with American Express and Diners Club) is a consequence of the way in which the VISA and MasterCard networks have developed and operate. Likewise, the fact that the rules of these networks give card issuers no direct choice as to the suppliers in relation to whom their cards will be used. The choice of suppliers is, in effect, delegated to the merchant acquirers in each country in which these networks operate, and provision is made, as one would expect, to ensure and monitor the reliability of such suppliers in the interests of all network members. That network rules may not provide all the protections that they might, e.g. by way of indemnity and/or jurisdiction agreements, is neither here nor there. They could in theory do so, and it is apparent that there are some differences in this respect between different networks. The Crowther Report and 1974 Act proceed on the basis of a relatively simple model which contemplated that card issuers would have direct control of such matters. A more sophisticated worldwide network, like VISA or MasterCard, offers both card issuers and card holders considerable countervailing benefits. Card issuers make a choice, commercially inevitable though it may have become, to join one of these networks, for better or worse.

Lord Mance was talking about the conditions that existed almost twenty years ago, because the case from which he was hearing an appeal went to trial in 2004. But, I think it is clear that even by then the commercial practices by which card networks recruited suppliers had evolved by developing a system that left supplier recruitment to intermediaries, and card issuers were faced with an essentially commercial decision as to whether to participate in network that included suppliers who had been recruited that way. Since 2004, new technology and the growth of internet commerce have opened up additional channels for recruiting suppliers and routing payment to them (for example, "payment facilitators", which are now an established part of the payments industry) and, again, card networks have changed their rules and practices in response.

Having provided some important context to the circumstances in Mr B's case, I need to now establish the exact nature of what happened as best I can and the relation between the parties involved.

The DCS issue

I have considered the particular facts of Mr B's case. In order for S75 to apply there has to have been 'arrangements' between Lloyds and the Firm A (Supplier) to finance transactions

between Lloyds's cardholders and Firm A. It's clear that there was no direct arrangement between them, but this isn't a requirement for the application of S75.

I say this because the Judge who heard the OFT case at first instance ([2005] 1 All ER 843) had also considered the meaning of the word "arrangements", as used in section 12, and whether there existed relevant arrangements between creditors and suppliers (the Firm A here) in the four-party situation. He said that the use of the word showed a deliberate intention on the part of the draftsman to use broad, loose language, which was to be contrasted with the word "agreement". In the Court of Appeal, the creditors argued that arrangements should be given a narrower meaning that took the four-party structure outside the definition. But the Court of Appeal agreed with the Judge that "arrangements" had been used to embrace a wide range of commercial structures having substantially the same effect. They held that it was not required for arrangements to be made directly by or between the creditor and supplier, merely that arrangements should exist between them, and it was difficult to resist the conclusion that such arrangements existed between credit card issuers and suppliers who agreed to accept their cards, and stated:

"Moreover, we find it difficult to accept that Parliament would have been willing to allow some consumers to be disadvantaged by the existence of indirect arrangements when other consumers were protected because the relevant arrangements were direct."

I've also considered the recent High Court case of Steiner v National Westminster Bank (2022) EWHC 2519 ('the Steiner case'). This case involved payments to a trust for the provision of a timeshare supplied by a timeshare provider. The High Court dismissed the claim under s.75 on the basis that the timeshare purchase was not made under a debtor-creditor-supplier agreement. This was because payment had been made in the first instance to the trust company, whereas the claim related to agreement to purchase a timeshare from the timeshare provider. Mr Steiner's credit card was issued under the MasterCard scheme and the trust company was a member of the MasterCard network, but the timeshare provider was not.

The Judge (Lavender J) held that central question was not whether "arrangements" existed between the bank and the timeshare provider at the time when Mr and Mrs Steiner had entered into their agreement with the timeshare provider and Mr Steiner had used his card to pay the trust company. Rather, the question posed by s.12(b) CCA was whether Mr Steiner's credit card agreement with the bank was made by the creditor (i.e. the bank) "under pre-existing arrangements, or in contemplation of future arrangements", between the creditor (i.e. the bank) and the timeshare provider.

When a bank made an agreement with one of its customers in relation to a card issued by the bank to the customer, then the agreement was made under the card network, which constituted "arrangements" between the bank and the other members of the network. So, if a supplier was already a member of the card network, the agreement was made "under pre-existing arrangements ... between the bank and the supplier". The bank was also aware that other merchants were likely to join the card network in the future, so in that respect the agreement was made "in contemplation of future arrangements", between the bank and merchant who subsequently joins the card network.
However, in the absence of specific factual evidence as to the bank's state of mind, the Judge said it was difficult to envisage that a bank which issued a card to its customer and made a credit card agreement in relation to that card made that agreement under, or in contemplation of, any arrangements other than the card network. And, as the timeshare provider was outside the card network, it didn't supply the timeshare under a debtor-creditor-supplier agreement.

Is there a DCS agreement?

The question of whether Mr B's transaction took place under a DCS agreement seems to me to turn in this case on two matters: first, whether there existed arrangements between Lloyds and Firm A for the financing of transactions with Firm A's customers; and second, if such arrangements existed, whether that was the case when Lloyds entered a credit agreement with Mr B or, if the arrangements came into existence after that, whether Lloyds contemplated that they would do so. I'll examine those questions in turn.

Arrangements

Our Investigator looked into the transaction primarily based on the information Lloyds had given this service about the presence of a fourth party in the transaction namely PayPal. Our investigator contacted PayPal and asked it what its role was in the transaction. PayPal responded and has been forthcoming in its role within this transaction and more broadly about the services it provides.

PayPal is a well-known provider of a variety of financial transactional services. This includes both payment processing and E-Money provision amongst other services. In this particular transaction PayPal has provided evidence around this specific transaction including saying:

"*I can confirm the purchase was made on the merchant's website via the customer's* PayPal *account as shown below*". It then shows two transactions for exactly the same amount of money at exactly the same date and time (to the second). One transaction is the amount (the cost of the ring) being charged to Mr B's Lloyds credit card to fund Mr B's account with PayPal. The second transaction is from Mr B's PayPal account to Firm A's account with PayPal. PayPal goes on to say:

"*This means the payment went from the customer's* PayPal *account to the Merchant's* PayPal *account and was funded with the card ending* (details of Mr B's Lloyds account). *As we are only the payment processor, I am unable to see the terms of the customer's agreement with the merchant* (Firm A)."

The transactional record PayPal has provided shows that Mr B's account with it was of a zero balance immediately before the transaction and returned to zero immediately after the transaction. It also shows the status of both transactions being "completed" and apparently instantaneous. It refers to the transaction paid to Firm A as being "*express checkout payment*". Such dual transactions are sometimes referred to as 'back to back' transactions.

PayPal explained that Firm A also had an account with it. In essence it appears that Firm A had outsourced its payments processes to PayPal in this instance. PayPal has terms and conditions including that all applicable network rules must be complied with. And within those terms and conditions some networks are named including Mastercard, the network relevant here. And I've also considered the network rules applicable here and this need to comply with the network rules is mirrored within those. So Firm A has an agreement with PayPal which includes the obligation of adhering to the card network rules here. PayPal is obliged to follow the same network rules also. And Lloyds, by using the card scheme here, is bound to follow the same card scheme rules as well. And Mr B's card use is governed by his obligations to Lloyds through his contract with it. In essence all parties here all have different roles but are all obliged to work within the rules of the network to complete the same transaction.

PayPal has said it acted as a Payment Processor in this transaction. It is clear that this transaction from Mr B's credit card to Firm A's account with PayPal is in essence instantaneous. The amount debited from Mr B's account is the same amount in Great British Pounds that is credited to Firm A's account. It also seems likely here that there is a

conversion to E-Money in the transaction from Mr B's card to his account with PayPal but I don't think it makes a difference here and doesn't prevent there from being a DCS agreement for reasons I shall give in this decision later.

I should add at this juncture that Lloyds has provided minimal representations to support its argument here on DCS. It hasn't provided detail about the exact journey of this transaction nor explained why it believes that there is no longer a relevant DCS relationship in regard to this transaction other than pointing to the presence of another party. It has not explained why the arrangement in this case should be distinguished from the established legal authorities. Nor has it chosen to provide supporting evidence about the agreements in place between the various parties. It has only pointed to PayPal and in essence said the mere presence of PayPal is proof that there is no relevant DCS relationship.

It may be that in this case there was a Merchant Acquirer as well. But whether there was a four-party arrangement here or indeed a five-party arrangement present in Mr B's case, either way I'm still satisfied that there are sufficient arrangements between Lloyds, as card issuer, and Firm A, as supplier, for the purposes of establishing a DCS relationship, I shall now explain why.

In Mr B's case, I think there are indications of relevant arrangements even before looking at the contractual obligations undertaken by the parties, given that PayPal was specifically, and publicly in the business of processing or facilitating financial transactions such as the transaction in this case. It should also be noted that PayPal is a very large company generating vast numbers of transactions which go through all the card networks every day. So clearly the network here (and other networks) have decided to allow such payments to go through their networks. And it would seem that considering the commercial benefits of such volumes of transactions this is entirely understandable.

Here PayPal *is* specifically and publicly in the business of providing financial transactional services to suppliers, such as Firm A. Lloyds would be able to know the parties within the arrangement here included PayPal and that PayPal's business involved processing payments under the network for its customers, such as Firm A. And Firm A was obliged through its agreement with PayPal to also be bound to follow the rules in the card network in this case. Fundamentally, it follows that Lloyds financed the transaction between Mr B and Firm A by making credit available at the point of purchase in accordance with the credit agreement between them. The fact that it does so through the medium of PayPal does not detract from that: it is Lloyd's agreement to provide credit to Mr B that provides the financial basis for the transaction with Firm A. And all of this done with all parties being required to comply with the card network rules.

I would also note that both Lloyds and Firm A undoubtedly benefit commercially from the involvement of the other, through the intermediations of PayPal (and any Merchant Acquirer present), in a way that makes it possible to allow the transaction to happen. By financing purchases from the Firm A, Lloyds are able to lend money to their customer (Mr B) and make interest and/or other charges for that service, whilst the Firm A is able to obtain payments from Lloyds's credit card holders and so benefit from the credit Lloyds extended (albeit indirectly).

Contemplation

It is possible that Lloyds may argue that such arrangements as those present in Mr B's case were outside of its contemplation at the time when it agreed with Mr B to open his credit card account, and thus there is no DCS agreement for it to be liable under.

Given that payments systems and card networks have continuously changed and evolved over the past half century, I think it likely that Lloyds always understood that the Mastercard scheme would be operated in accordance with evolving rules and commercial practices, and that this evolution was likely to bring in new groups of network participants. Lloyds must have known Mastercard would try to adapt its network to accommodate major changes in the payments industry; and it would certainly not have expected that each customer to whom it issued a credit card would only make purchases from the suppliers recruited under the rules and practices applicable at the date when the credit agreement was first entered into. Rather, it would have contemplated that all its credit card holders would (irrespective of when their credit agreement started) have access to the same suppliers, i.e. those suppliers allowed under the Mastercard network. So, I think Lloyds must have contemplated, when agreeing to give Mr B a credit card, that his card would be used to finance purchases from whatever suppliers the network's changing rules and practices accommodated at the time of the purchase.

In this case, the credit card payment went to Firm A via PayPal which are/were recognised participants in the same card scheme as Lloyds, and this transactional process between debtors and suppliers is commonplace within the rules of the scheme. It is a method of payment to a type of supplier that the network's rules and practices accommodate and, as such, I consider that it was within Lloyd's contemplation when the credit card agreement was entered into.

Conversion

Lloyds may point to the conversion from Sterling to E-money as a reason for why there might no longer be a DCS agreement. But I'm not persuaded by this either, because had there been a conversion of foreign currency in the transaction as is the case in huge numbers of credit card transactions used during holidays abroad the accepted position is DCS isn't broken. And usually in such foreign transactions there is a fee charged for providing the added service of the currency exchange. It is important to remember here that the entire sum here was funded by the Lloyds credit card. This transaction wasn't funded by the balance already held in the account with PayPal. This was a near instantaneous transaction from Mr B's Lloyds credit card to Firm A through the intermediation of the financial transactional service as provided by PayPal. And I cannot see a fee being directly charged for the exchange to E-money here. And even if there was such a fee whether directly applied to the transaction or as part of the overall service that PayPal provided, I don't think it would make this transaction distinguishable from the other types of currency exchanges I've described.

I should also note that PayPal in its evidence to this service previously has stated that its 'Guest Checkout' service converts to E-Money but doesn't disrupt the DCS relationship. So I'm not persuaded the conversion in itself should prevent there from being a DCS agreement here as, to my mind, this conversion does not negate the arrangements in place between the parties as I've described.

Accounts

It may be that Lloyds points to the fact that the transaction journey is from Mr B's card into Mr B's account with PayPal and then onto Firm A's account with PayPal as a reason why to consider their might not be a DCS agreement. But I'm not persuaded by this. There are still the necessary arrangements to my mind. Merchant Acquirers, Payment Processors and those parties providing currency conversion services have accounts in which transactions pass through on their journey from debtor to supplier. I've not seen any persuasive reason to distinguish what happened here from the authorities mentioned before.

The network stance

Mastercard's public stance on this matter generally is unclear from my research. I do note however that one of the other major networks (Visa) has made clear on its website that it does, at least imply, that DCS isn't disrupted. It has said:

"*If your Visa card purchase was made using a digital wallet where the payment was made with a linked card, chargeback and Section 75 claims work in the same way as if you paid directly with your card*."

So all in all I've not seen any persuasive evidence at this stage that the additional services provided by PayPal interrupts the DCS relationship. I'm also satisfied this transaction fits within the financial limits set out in relation to S75 claims as described in the Act. Accordingly I'm satisfied at this time that there is the necessary DCS agreement and a S75 claim can be successful if the other requirements are made out. However I have used this provisional decision to drive out arguments from all sides here in order to come to a fair final decision.

liability

As I've explained, for Lloyds to be liable under S75 a breach of contract or a material misrepresentation needs to be made out. Mr B has submitted in support of his claim a report from a jeweller's who have inspected the ring. The report says:

"Having inspected the above item under magnification I have observed damage to two of the claws due to the metal being poorly cast resulting in porosity and subsequent brittleness, causing metal fracture when the claws are caught. Pitting is evident on both fractured surfaces, with at least one other claw demonstrating incomplete fracture. There is clear evidence of the ring having been resized, however this wouldn't affect the integrity or stability of the claws."

I also note in Firm A's product details supplied to Mr B when he bought the ring it describes the following as being included with the product:

"3-year warranty protection on all our products which includes manufacturing defects such as metal fracturing and porosity, it does not include wear and tear and certificate for any diamonds".

All goods should be of satisfactory quality. It is evident here that this ring wasn't of satisfactory quality when purchased as it is clearly insufficiently durable due to the casting and evident porosity. So based on the independent evidence here I'm satisfied that the ring wasn't of satisfactory quality at the point of sale. I'm not persuaded these failings were due to fair wear and tear. I think they became evident through the normal day to day usage of the ring. Furthermore I'm satisfied on balance these issues with the ring came to light within the warranty period which specifically covers the failings identified in the ring here. So I think it would also be covered under the warranty.

Summary

Considering my rationale set out above (and in my provisional decision) and considering the subsequent responses of Lloyds and Mr B, I am satisfied that under S75 that there is a breach of contract here and Lloyds is liable for the reasons given.

Putting things right

Mr B has requested a full refund for the ring. I think such a ring should be expected to last many years, so I don't think a reduction for usage here is fair. Taking into account all of the circumstances I think this is a fair remedy, so I direct Lloyds to make a full refund for this transaction to purchase the ring. Lloyds can take possession of the ring if it so wishes before making the refund. If this is the case it should inform Mr B within 28 days of the date of this decision. Lloyds must also pay 8% interest on this amount from when it rejected Mr B's claim to it until it settles this matter.

My final decision

It is my decision that this complaint is successful. It is my decision that there is the required DCS agreement under s.75, and on balance, that there is a breach of contract. So I'm satisfied that Lloyds Bank Plc should compensate Mr B for the loss suffered here as I have described above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr B to accept or reject my decision before 17 May 2023.

Rod Glyn-Thomas
Ombudsman