IN THE HIGH COURT OF JUSTICE CR-2019-BHM-443
BUSINESS AND PROPERTY COURTS
INSOLVENCY AND COMPANIES LIST (Ch D)

IN THE MATTER LENDY LIMITED (IN ADMINISTRATION)

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

B E T W E E N:

(1) DAMIAN WEBB and others
(as administrators of Lendy Limited)
(2) DAMIAN WEBB and others
(as administrators of Saving Stream Security Holding Limited)
Applicants

-- and --

(1) LISA TAYLOR
(2) CHRISTINE LAVERTY and others
(as conflict administrators of Saving Stream Security Holding Limited)
Respondents

SKELETON ARGUMENT
ON BEHALF OF THE FIRST RESPONDENT
(for trial starting 28 June 2021 before HH Judge Rawlings)

Andreas Gledhill Q.C.
Carmine Conte

Blackstone Chambers
Temple, London

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(A) Introduction.

1. This is an application by the joint administrators of Lendy Limited ("**Lendy**") and Savings Stream Security Holding Limited ("**SSSHL**") for directions pursuant to para. 63 of sch. B1 to the Insolvency Act 1986 ("**IA86**") to resolve certain issues of principle that have arisen in the course of the two administrations. In broad terms, those issues concern the competing entitlements of three classes of person: (1) the Model 1 Lenders; (2) the Model 2 Lenders; and (3) the other unsecured creditors of Lendy (including creditors in respect of administration expenses).

2. The application was issued on 10 July 2020. At an early stage, the Financial Conduct Authority (the "**FCA**") indicated that it was considering intervening to make submissions, to safeguard the position of Model 1 and Model 2 Lenders [A/8]. On 25 September 2020, however, the first respondent, Lisa Taylor, was directed to stand as a representative on behalf of the class of Model 2 Lenders [A/11/154], and the Administrators have subsequently agreed for her costs to be paid as an expense of the Lendy administration. The court will thus have the benefit of adversarial argument on the principal points for decision, and the FCA is consequently not appearing [D/48/141].

3. Damian Webb has filed three relevant witness statements on behalf of the Administrators (Webb 2 [B/1/1], Webb 3 [B/2/67], and Webb 5 [B/5/129]), and Ms. Taylor has indicated that she does not intend to cross-examine him on those statements. There are two witness statements on behalf of the Model 2 Lenders, being Melton 1 [B/3/70] and Powell 1 [B/4/87], and the Administrators have indicated that they intend to cross-examine each deponent. Subject to that, the facts are largely common ground, and are recorded in an agreed statement of facts (the "**SOAF**" [A/4/15].

4. Over the course of these proceedings, the issues have narrowed, with certain of the issues originally live now deferred, pending the outcome of this hearing, and others now agreed. They are dealt with below in three broad groups: (1) those relating specifically to the position of the Model 1 Lenders (section (B) below); (2) those relating to Lendy's default interest charges in respect of Model 2 loans (sections (C)-(E) below); and (3) the

distribution of the proceeds of security realisations by SSSHL, in its capacity as trustee (section (F) below).

5. A list of pre-reading has been agreed between the parties, and may be found at [A/16/185]. What follows assumes a prior familiarity with that pre-reading, and consequently, focusses on submissions rather than on narrative. Capitalised terms not expressly defined bear the meanings ascribed to them in the SOAF and Final List of Issues [A/2/6], and underlining in quotations has, in all cases, been added by the writers of this skeleton argument.

(B) Issues 3-4: the rights of Model 1 Lenders.

(B)(i) Issue 3: were Model 1 loans limited recourse loans only?

6. Issue 3 is the first of two short issues concerned with the rights of Model 1 Lenders:

   6.1 Under Model 1, investors lent monies to Lendy to on-lend, as principal, to the underlying borrowers. No-one suggests Model 1 lenders have any proprietary claims against the Lendy estate, and when they originally issued this application, the Administrators did not seek any separate directions as to their (the Model 1 Lenders') position.

   6.2 At the second CMC on 23 October 2020, however, an issue arose as to whether Lendy was only obliged to repay Model 1 loans if and to the extent it (Lendy) was itself repaid by the underlying borrowers, and the court concluded that point was at least arguable. In subsequent correspondence, Ms. Taylor agreed to carry the argument in support of that position [D/34/82] in default of anyone else being willing to do so, and her agreement on that point was embodied in §5 of the order at the 21 December 2020 CMC [A/13/170].

7. The starting point for this topic is the uncontroversial proposition that "*although a borrower is in the ordinary way personally liable to repay a loan, whatever security he may give for it, it is perfectly possible to have a contract of loan in which the borrower is under no personal liability*" (*Chitty on Contracts* (33rd ed.) vol. 1 §39-263). As Professor Goode notes in *Consumer Credit Law and Practice* (loose-leaf) §11.73: "*whilst an obligation to repay is an essential characteristic of a loan, the manner in which the obligation is to be discharged may be restricted. In particular, it is not necessary that the borrower should incur a personal obligation to repay out of his own monies. It suffices that payment is to be made from a designated fund or from the proceeds of a specified asset. So an undertaking by B to repay an advance with such money (if any) as has come into his hands from T makes B a borrower despite the fact that his repayment liability is limited to the sums received from T*".

8. Whether a loan agreement gives rise to a non-recourse repayment obligation of this type is referable to its terms, construed in accordance with the familiar principles

summarised in *Arnold v. Britton* [2015] A.C. 1619 (H.L.), and *Wood v. Capita Insurance Services Limited* [2017] A.C. 1173 (S.C.). The relevant agreement here is the Model 1 Terms [C/4/72], and Ms. Taylor submits that it unequivocally bears out the construction suggested at the October 2020 CMC. Putting the point at its simplest:

8.1 Model 1 Terms clause 4.5 [C/4/74] stated that "*by funding a loan, you are agreeing to enter into a Loan Agreement with Lendy*". But clause 4.6 provided that "*the loan will remain in place <u>until the borrower repays the loan</u>, upon which time the funds plus interest earned will be made available to you for withdrawal or reinvestment*".

8.2 Those underlined words controlled whether Lendy was obliged to action a request for a "*withdrawal or reinvestment*" at all, and if so, when, and to what extent. Thus, if a given borrower only ever repaid 20% of the principal in respect of his loan, Lendy was under no obligation to participating Model 1 Lenders in respect of the 80% balance. To the extent the borrower failed to repay it, there was nothing left of his original investment for the relevant Model 1 Lender either to "withdraw" or "reinvest", within the meaning of clause 4.6.

9. That analysis is powerfully corroborated by the provisions of the Model 1 Terms more generally, furthermore:

9.1 The whole tenor of the Model 1 Terms (and indeed, Lendy's promotional literature more generally) was that investors were investing in pre-existing loans already written by Lendy. See:

9.1.1 The recital at the top of the first page [C/4/72] ("*opportunities are made available … for investors to invest in loans made to borrowers*").

9.1.2 Clause 1.2 on the same page ("*Lendy permits investment … into existing asset backed secure loans already in place*").

9.2 Reflecting that fact, the Lendy platform contained key information about each open loan which was relevant to investors' decisions whether or not to invest in

it: "*the Loan Amount, the Security Value of the Asset, the Loan To Value Ratio (LTV) … a redacted valuation report where available, and a short description of the Borrower's requirements*" (clause 4.3 [C/4/74]).

9.3 All of this would have been (at best) superfluous and (at worst) misleading if Lendy had itself been liable to repay the full amount subscribed by the relevant Model I investors upon borrower default. The whole point of providing such information was to enable investors to assess for themselves the credit risk they were running, by investing in any given peer-to-peer loan.

9.4 For precisely that reason, while Lendy guaranteed "*the enforceability of all its existing Loan Agreements*" (see clause 4.4 [C/4/74]), it expressly disclaimed responsibility for the price the security given for them might fetch if auctioned following default (see clause 5.3 at the top of [C/4/75]), and provided for Lendy to be separately liable in only the following two limited cases:

9.4.1 "*In the event that the asset* [*i.e.* the asset subject to Lendy's security: see clause 17.2 [C/4/82]] *turns out to be stolen or fake, Lendy will reimburse all invested funds to Investors*" (clause 5.4.5 [C/4/75]).

9.4.2 "*If the Asset is not sold at auction, Lendy will settle the Borrower's loan at the reserve price, and legal title to the Asset will pass to Lendy …* " (see the immediately following clause numbered (3) [C/4/75]).

9.5 Those provisions are flatly inconsistent with reading the Model I Terms as having created some more general obligation on the part of Lendy to permit investors to withdraw or reinvest monies the underlying borrower failed to repay, and the court will note that they were buttressed by restrictive limitations on Lendy's liability in section 12 of the Model I Terms [C/4/80] which are similarly inconsistent: see *e.g.* clause 12.3 ("*Our liability to you <u>on any basis whatsoever</u> shall not exceed the total amount of revenue earned by Lendy in respect of transactions entered into by you through Lendy …* ").

(B)(ii) Issue 4: are Model 1 Lenders' claims subject to the costs of realisation?

10. Issue 4 only arises if the answer to Issue 3 is as submitted above. Issue 4 was not a point Ms. Taylor was directed to argue by the 31 December 2020 order, but since it was addressed in her position paper (see §9 at [A/10/137], she suggests the correct analysis to be as follows:

    10.1 Model 1 Terms clause 7.1 [C/4/76] provided that "*Lendy pays all fees on behalf of its investors. Lendy does not make any charges or fees* [sic] *to its investors*". Subject as follows, the default position is, consequently, that Lendy was not entitled to make deductions from its receipts from Model 1 borrowers to cover its own costs of realisation.

    10.2 The general provision at clause 7.1 has to yield, however, to the more specific provision of clause 5.2.4 (second paragraph on [C/4/74]), governing sale at auction. That provision stipulates for "*an additional fee of 5% of loan value*", deductible from the "*net proceeds*", *i.e.* what remains "*after deduction of selling expenses such as commissions*" (see the first sentence).

    10.3 There is then a question as to how that 5% fee ranks in order of priority, in light of clause 5.2.4, and the waterfall prescribed at paragraphs (1)-(4) immediately following that clause. There are two possibilities:

        10.3.1 The 5% is deducted <u>before</u> repayments in respect of the "*principal amount of the loan*" (*i.e.* before paragraph (1) of the waterfall). This is what the first sentence of clause 5.2.4 says, in terms, but entails the consequence that paragraph (2) of the waterfall appears to be redundant, as there seem to be no other "*fees due to Lendy*" in the Model 1 Terms.

        10.3.2 The 5% is paid out at paragraph (2) of the waterfall, *i.e.* as "*fees due to Lendy*", if (and only if) there is enough first to meet the "*principal amount*

of the loan". This saves paragraph (2) from redundancy, but cuts across the clear terms of the first sentence of clause 5.2.4.

10.4 As between those options, Ms. Taylor suggests the first sits more comfortably with the language. On this basis, paragraph (2) of the waterfall is simply referring to such other fees in addition to the 5% as there may be: and this reading is consistent with the opening words of clause 5.2.4. The reference there to "*an additional administration fee of 5%*" indicates that the drafter had in mind that other fees might in fact be due, and it was those fees that were intended to rank for payment at paragraph (2).

(C) Issue 5: default interest in respect of the Model 2 Loans.

(C)(i) Overview of this issue.

11. Issue 5 concerns the default interest ("**DI**") charged by Lendy, where loans were not repaid in time, and more particularly, who is entitled to it, as between the Model 2 Lenders and Lendy itself. Ms. Taylor says Lendy recovered DI as agent for the Model 2 Lenders, and holds it to their account (§10 at [A/8/137]); the Administrators maintain Lendy recovered DI either wholly, or partly, for its own account (§26-§27 at [A/7/78]).

12. This reduces to the question whether Model 2 Lenders had legal title to the chose in action represented by the claims against borrowers for DI, *i.e.* whether they could have sued borrowers to recover DI in their names. If so, then irrespective of whether Lendy could <u>also</u> have sued to recover DI as their agent (and in fact did so), Model 2 Lenders will have had title both to the debt, and a claim to the proceeds of it in Lendy's hands: see *Bowstead & Reynolds on Agency* (22nd ed), art. 52, §6-099--§6-100.

(C)(ii) Applicable legal principles.

13. The general principles relevant to this issue are set out in *Bowstead* arts. 97-100 (§9-001--§9-042), and so far as presently material, they may be summarised as follows:

    13.1 The starting point is that "*where a person contracts as agent for a principal, the contract is the contract of the principal and not that of the agent; and, prima facie, at common law the only person who may sue is the principal and the only person who can be sued is the principal*" (§9-002).

    13.2 The general rule may be displaced, however. The facts of a given case may entail the conclusion that the agent and principal are both entitled to sue or be sued, or even that the agent alone is so entitled: it all "*depends on the intention of the parties, to be deduced from the nature and terms of the particular contract and the surrounding circumstances … As in all matters of formation of contract, the test is objective*" (§9-005).

13.3 If an agent signs an agreement "*indicating that he or she signs as agent, or for or on behalf of the principal, the agent is deemed not to have contracted personally, unless it is plain from other portions of the document that, notwithstanding such qualified signature, the agent intended to be bound*" (§9-037). If it is, the conclusion will be that the agent has contracted "*as agent in some respects and as principal … in others*" (§9-036).

14. Before applying those principles to the facts, two preliminary points may be made. The first is that the question of whether Lendy was exclusively <u>liable</u> to borrowers under the terms of its Model 2 loan agreements was considered and decided by Zacaroli J. in *Lederer v. Allsop LLP* [2018] EWHC 1425 (Ch):

14.1 In that case, the claimant company was a borrower, who alleged there to have been a repudiatory breach of the obligation to lend (§4). It did not know the names of the relevant lenders, and sought an order for disclosure of their identities, so it could join them as defendants to the claim (§7).

14.2 Lendy itself appeared on the application (§3, last sentence), and resisted that application on the basis that "*Lendy is the only person who is liable to be sued under the contract*". It argued that both the loan agreement with the claimant, and connected documents, dictated that result (§8-§12).

14.3 The judge found that "*there are a number of features of the loan agreement and connected documents which clearly identify the lenders and not the agent as the real contracting party*" (§14). Specifically so far as the loan agreement was concerned, he said that it was "*on the face of it entirely consistent with the position that the agent acts only as agent, and that the principal is the real party in interest*" (§19).

14.4 He consequently concluded that "*the real contracting party is the lender, not the agent. Far from there being an express provision removing liability of the principal, the contract clearly indicates that the lenders and not the agent have the obligations, and are liable, under the agreement*" (§21).

15. There are the following points to make about *Lederer* and its relevance:

15.1 Zacaroli J.'s conclusion on the issue of whether lenders could be liable for breach of Model 2 loan agreements was consistent with clear provision in Lendy's lender terms, as follows:

15.1.1 Clause 7.8 of the Original Model 2 Terms said this: "*a Loan Contract is between the lender and the borrower. Saving Stream and/or Saving Stream Security Holding has no liability in relation to the Loan Contract*" [C/14/271].

15.1.2 Clause 7.8 of the Amended Model 2 Terms said this: "*A Loan Contract and any related security* <u>*is a bilateral agreement between the lender and the Borrower*</u>*. Lendy and/or Saving Stream Security Holding has no liability for payment or repayment of any amounts due in relation to the Loan Contract or any security document*" [C/15/291].

15.2 The decision in *Lederer* does not answer the specific question which this court now has to resolve, which is whether Model 2 Lenders were not only <u>liable</u> to be sued by borrowers under the loan agreement, but <u>entitled</u> to sue them in their own names (rather than Lendy's) in respect of DI. It is, however, an important starting point, because while "*an agent may undertake liability without being entitled to sue … he cannot easily be entitled to sue if he is not liable, for there would usually be no consideration to support the liability of the other party*" (*Chitty* §31-084 (text to note 605).

16. The second preliminary point arises out of the underlining in the quotation from Amended Model 2 Terms clause 7.8 in paragraph 15.1.2 above. Why did Lendy amend its lender terms in March 2018 specifically to stipulate that a loan contract was "*a bilateral agreement between the lender and the Borrower*"? The answer lies in the regulatory framework:

16.1 Lendy obtained an interim authorisation from the Financial Conduct Authority (the "**FCA**") in February 2014 (generally Webb 2 §16 [B/1/5]), and in March

2016, applied for full authorisation to conduct the regulated activity of "*operating an electronic system in relation to lending*" (see [E1/31/112], and more generally, Webb 2 §48 [B/1/12]).

16.2 As the court is likely to be aware, the classes of permitted regulated activity are specified by delegated legislation made pursuant to s.22(1) of the Financial Services and Markets Act 2000 ("**FSMA**"), being S.I. 2001/544 (the Regulated Activities Order, or "**RAO**"), and what counts as "*operating an electronic system in relation to lending*" is prescribed by RAO art. 36H (in force with effectfrom 1 April 2014).

16.3 That provision contains a number of threshold conditions, of which the most relevant for present purposes are paras. (1), (4) and (4A) of art. 36H:

16.3.1 Para. (1) provides that the activity of operating an electronic lending platform is only a "*specified kind of activity*" for FSMA s.22(1) purposes if conducted pursuant to "*an article 36H agreement*".

16.3.2 Para. (4) provides (so far as material) that an article 36H agreement is one that provides that the operator (here, Lendy) "*does not provide credit, assume the rights (by assignment or operation of law) of a person who provided credit, or receive credit under the agreement*" (para. (4A)).

16.3.3 The term "*credit*" is defined as follows, in art. 60L: "'*credit' includes a cash loan or any other form of financial accommodation*".

16.4 The FCA granted Lendy full authorisation on 10 July 2018 (Webb 2 §61 [B/1/14]), *i.e.* over 2 years after its application. In the lengthy intervening period, there were extended discussions between Lendy and the FCA, some (but by no means all) of which have found their way into the bundle for this hearing.

16.5 Of particular relevance for this purpose is the letter from the FCA to Lendy dated 1 June 2017 which the court will find at [E1/79/264], in which the FCA

discussed (among other things) whether Lendy's then arrangements were art. 36H compliant: see generally section (2), starting at the bottom of the first page of the letter ("2. *Lendy Ltd.'s compliance with the A36H perimeter*"), and running down to [E1/79/267].

16.6 The Authority's concern (put broadly) was that whereas the RAO art. 36H regulated activity was one of facilitating transactions between individual lenders and borrowers (see art. 36H(1)): -

16.6.1 Lendy's borrower and lender terms created "*a single multilateral loan from the lenders to the borrower, rather than multiple bilateral loans from each lender to the borrower*" [E1/79/266]. And:

16.6.2 Lendy's practice was that if insufficient lenders came forward to fund a loan, it sometimes made up the difference itself, thereby acting as a principal rather than simply a facilitation agent, in contravention of RAO art. 36H para. (4A).

16.7 This intervention appears to have driven the amendment, some 10 months later, of clause 7.8 of the Original Model 2 Terms 8, to refer to each lender/borrower agreement as "*bilateral*" (see paragraph 15.1 above). But the FCA's intervention is of more general relevance, because it underlines the point that the issue as to the respective rights of Lendy and the Model 2 Lenders falls to be assessed against the regulatory framework. The terms of RAO art. 36H are a key part of the background against which the intention of the parties falls to be considered, on the usual objective basis (see paragraph 13.2 above).

(C)(iii) Relevant facts.

17. Before turning to the analysis, some factual points are in order. Focussing first on the non-default interest charged to Model 2 borrowers:

17.1 So far as material, relations between Lendy and Model 2 borrowers were the subject of two separate agreements:

17.1.1 Lendy's Model 2 Terms and Conditions for Borrowers [C/7/112]. These regulated the terms on which borrowers were admitted by Lendy to its platform (*i.e.* the RAO art. 36H "*electronic system*").

17.1.2 Lendy's standard form Model 2 loan agreement ([C/8/123] for individuals, and [C/9/137] for corporates). These governed the terms of the loans which were subsequently made between lenders and borrowers through that platform.

17.2 In respect of the Terms and Conditions, Lendy and SSSHL contracted as principals: see the signature block at [C/7/112]. So far as the loan agreements were concerned, however, Lendy signed expressly as agent for the Model 2 lenders ("*signed by … a director acting on behalf of Lendy Limited as agent of the Lenders*" [C/8/136]).

17.3 Non-default interest was payable under the Model 2 loan agreements at the "*Interest Rate*", pursuant to clause 6.1 [C/8/127]. The "*Interest Rate*" was defined by clause 1.1 by reference to the Term Sheet [C/8/125], which expressly provided for two Interest Rates, one "*payable to Lenders*", and the other "*payable to Saving Stream*" [C/6/109].

17.4 Model 2 lenders were told about this dual interest charge <u>if</u> they looked at the page on Lendy's website entitled "*How it Works*", which (for at least some of the material time stated as follows: "*Since it's* [sic] *launch by Lendy Ltd in 2013, Saving Stream has made its profit from the difference in interest rates charged to borrowers and paid to investors. All Saving Stream investors receive a fixed monthly interest amount of 1% whereas Lendy Ltd charges interest at 1.5% per month on average*" (see Powell 1 §56 [B/4/104], and [E1/33/138]).

17.5 It is common ground, however (see Webb 5 §18 [B/5/133]), that borrowers never in fact had to make any payments in respect of clause 6.1 (non-default) interest, whether to Lendy or lenders. This resulted from the following provisions of the Model 2 Terms and Conditions for Borrowers (see paragraph 17.1.1 above):

17.5.1 Clause 4.1 provided that if a borrower accepted a loan, Lendy "*will charge you the interest rate set out in the Loan Contract* <u>*on the date of drawdown of the loan*</u> *(acting as agent on behalf of the lenders)*".

17.5.2 Building on those underlined words, clause 4.2 stated that Lendy "*will deduct the interest set out in clause 4.1 and Arrangement Fee* [sic] *from the amount borrowed before it is transferred to you so you will receive the amount borrowed less the interest and Arrangement Fee …* " [C/7/116].

18. Now turning to the DI paid by borrowers:

18.1 DI was payable under clause 6.3 of the Model 2 loan agreements, which provided as follows: "*if the Borrower fails to make payment due under this agreement on the due date for payment, interest on the unpaid amount shall accrue daily, from the date of non-payment to the date of actual payment … at 3% per month above the aggregate Interest Rate*" [C/8/127].

18.2 But whereas the term sheet conferred an express entitlement on Lendy in respect of non-default interest, it conferred no such entitlement in respect of DI. It made no separate mention of it, and nor was it referred to either in the Model 2 Terms and Conditions for Borrowers, which was the basis for Lendy's separate contract, as principal, with the borrowers.

18.3 The rate of DI to which clause 6.3 gave rise (assuming non-default interest of 18% per annum) was 54% per annum (*i.e.* 18% + 36%). The court can get an idea of how fast that caused the amount owing by the borrower to escalate

substantially from the worked example given at Webb 2 §222(i) [B/1/53], which takes the case of a £2m for a 3 month agreed term:

18.3.1 The total non-default interest payable to lenders at the end of that 3 month term, calculated at 1% per month, was £60,000 ((2,000,000/100) x 3 = 60,000).

18.3.2 But after the due date, DI accrued at the rate of £3,068 per day (*i.e.* ((20,000) x 54)/352), with the consequence that Lendy was itself owed more than the £60,000 owed investors within 21 days of the date of default.

18.4 On the Administrators' primary case, however, not a penny of that DI is, or ever was, payable to Model 2 lenders: see §26 of their position paper at [A/7/78]. This is an ambitious submission, not least, because it appears to suggest that after the repayment date, lenders had no contractual entitlement to any further interest at all. Even Lendy itself did not take that position, before administration:

18.4.1 As Webb 2 §118 accepts, Lendy did, in fact, tell lenders that they were entitled to what it termed a "*bonus accrual*" in respect of loans that went overdue, "*once the loan has been repaid and if we are successful in recovering sufficient property proceeds*" [E3/187/938].

18.4.2 That entitlement was also embodied in the First Recovery Policy, which Lendy emailed out to lenders on 13 April 2018 (Powell 1 §77 [B/4/117]): "*once a loan passes its due date default interest will begin to accrue … <u>a portion of this default interest</u> will accrue in the investors* [sic] *favour as bonus accrual. Bonus accrual is calculated on a daily basis at half the usual interest rate*" [E2/111/489].

18.4.3 Webb 2 §198 [B/1/43] originally claimed that Model 2 lenders were "*never paid any element of default interest*", but on the assumption (as must be the case) that this "*bonus accrual*" was paid to lenders out of

DI payments received by Lendy, Webb 5 §41(b) now accepts this was incorrect: see further [E3/200/984] for details of the actual payments.

18.5 A careful reading of the First Recovery Policy will have flagged to an astute lender that Lendy was charging DI at a higher rate than it was passing it on: see the underlined words in paragraph 18.4.2 above. But copies of the loan agreements were not uploaded to the Lendy website (see Webb 2 §123-§124 [B/1/25]; Melton 1 §44 [B/3/82]; Powell 1 §59.6 [B/4/109], §70.2(c) [B/1/113], §81 [B/1/121], and §97.1(e) [B/1/127]), and nor were lenders otherwise informed what DI Lendy was charging to borrowers. They consequently had no means of knowing how much Lendy was keeping for its own account, or accruing against the security held on trust by SSSHL.

19. In correspondence in March 2018, the FCA made the obvious point that if lenders did not know what charges were payable to Lendy by borrowers in a default situation, they were unable to judge the impact of those charges on their (*i.e.* the lenders') ability to recover their capital [E2/109/475]). As discussed in more detail in paragraph 51 below, Lendy batted that concern away at the time with bland assurances that lenders would always rank ahead of Lendy's own claims (claiming this to be "*a key foundation stone of the business*" [E2/109/476]), but subsequently reneged on those assurances, without telling either the FCA, or lenders. How much damage to Model 2 lenders flows from that depends to a large extent on whether the Administrators are right in submitting that Lendy is entitled to keep DI for its own account.

(C)(iv) Ms. Taylor's analysis of Issue 5.

20. It is not disputed that as between the lenders and Lendy, Lendy was duly authorised to collect DI from borrowers. This was, in fact, a precondition to Lendy validly conducting the RAO art. 36H authorised activity: see art. 36H, para. (1) and para. (2C)(b). But it does not follow that Lendy was exclusively so entitled, as against the borrowers, and whether that is so or not turns on the terms of the loan agreements, as construed on ordinary principles. Ms. Taylor suggests that they unequivocally entail the conclusion that lenders could also sue, for the following eight reasons:

20.1 First, Lendy expressly signed the loan agreements in its capacity as agent for the lenders. The starting point in this case (as it was in *Lederer*) is consequently that the right to enforce, as between the parties to those agreements, rested with the lenders, and not with Lendy: see paragraph 13.1 above.

20.2 Second, there is nothing in the loan agreements that warrants the conclusion that Lendy could sue for DI to the exclusion of the lenders. Clause 6.3 is silent about who DI has to be paid to. Even clause 7, governing repayment of principal and pre-default interest, does not stipulate whether payments should go to Lendy or the lenders.

20.3 Third, in their position paper, the Administrators rely heavily on the fact that the term sheet stipulated for part of the "*Interest Rate*" (*i.e.* non-default interest pursuant to clause 6.1) to be payable to lenders, and part to Lendy itself. This proves nothing. Lendy never had to sue borrowers for non-default interest because it deducted it up front from the lenders' own advances: see paragraph 17.5 above. The provisions as to non-default interest consequently have no bearing on whether lenders could sue for DI as principals, in their own name.

20.4 Fourth, the Administrators have asserted in evidence that the function of DI was to defray Lendy's higher costs of realising overdue loans: see *e.g.* Webb 2 §200 [B/1/43]. As it happens, there is no contemporaneous evidence corroborating that claim, but more fundamentally, the function DI may have played from Lendy's internal perspective is nothing to the point:

20.4.1 What matters is the intention of the parties to the loan agreement, objectively assessed, and so far as that is concerned, the key point is that the monies payable pursuant to clause 6.3 were expressed to be "*interest*", and not some other sort of charge.

20.4.2 Interest is parasitic (*Teesside Power Holdings Ltd. v. Electrabel International BV* [2012] EWHC 33 (Comm), at §76). Its very nature is to serve as a

reward for the risk run by the lender in respect of his loan of the principal. It would be surprising to arrive at the result that something expressed to be payable by way of interest should be payable exclusively to someone other than the lender, and *a fortiori* default interest: cf *Credit Suisse v. Titan Europe* [2016] EWCA Civ 1293, at §49 ("*it is difficult to think of any commercial transaction when parties would intend to reward a person … by reference to the default of a third person*" (Arden L.J.)).

20.5 Fifth, and relatedly, if Lendy had in fact wanted to stipulate for DI (or an equivalently calculated administration charge) to be payable to it, but not to the lenders, it could have done so by the simple expedient of providing for it in the separate agreement it concluded as principal with the borrowers (see paragraph 17.1.1 above), and had it done so, there would have been good consideration for the borrowers' undertaking to pay Lendy such sums. Instead, it quite specifically opted to embed the right to DI in the loan agreements, to which it was expressed to be a party as agent for the lenders only, and under which it incurred no liabilities to the borrowers: see the discussion of *Lederer*, in paragraph 15 above.

20.6 Sixth, and again relatedly, the Administrators' suggestion that Lendy should be regarded as having all along been charging interest for its own account sits uncomfortably with the regulatory scheme referred to in paragraph 16 above. The essence of the RAO art. 36H regulated activity is that the electronic platform operator is an intermediary, facilitating transactions between multiple individual lenders and borrowers: see art 36H para. (1). This obviously does not preclude it (the facilitator) from charging for its services: but interest is qualitatively different. It is the consideration payable and due between the substantive parties to the transaction of loan, not a reward for its facilitation.

20.7 Seventh, if the Administrators' suggestion were right, it would create a situation in which the interests of Lendy and the Model 2 lenders were potentially at loggerheads. Lenders' interest was in seeing their interest paid, and their capital repaid in full on the due date. But if Lendy was entitled to charge default interest

for its own account at the substantial rate discussed above, there was a clear likelihood of conflict, as the Administrators' own example at paragraph 18.3 above vividly illustrates. Applying commercial common sense, it cannot have been the parties' shared intention to create a structure in which the interests of lenders and their agent (Lendy) pulled in opposite directions.

20.8 Eighth, the conclusion that lenders had direct claims against borrowers in respect of DI is corroborated by the terms of the standard form personal guarantees that sat alongside the Model 2 loans [C/11/191], which document is part of the matrix against which the loan agreements fall to be construed:

20.8.1 Section 5 made provision for the recovery of interest, and clause 5.3 said this: "*the Lenders shall not be entitled to recover any amount in respect of interest under both this guarantee and any arrangements entered into between the Borrower and the Lenders, including but not limited to those in the Loan Agreement …* " [C/11/197].

20.8.2 The term "*Lenders*" in the guarantee was defined to mean the Model 2 lenders, as opposed to Lendy itself, which was defined as the "*Agent*": see the definitions on [C/11/193], and the interest being referred to in clause 5.3 was (and was only) DI (see clause 5.1).

20.8.3 Clause 5.3 is, consequently, consistent with lenders having claims for DI against borrowers, and inconsistent with Lendy having such claims in its own right.

21. The Administrators' principal answer to all this (as Ms. Taylor presently understands it) is that clause 9 of both the Original and Amended Model 2 Terms (see respectively [C/14/272] and [C/15/292]) gave Lendy a beneficial entitlement to some part of the interest charged, and clause 13.4 of the Amended Model 2 Terms [C/14/297] further provided for borrowers to "*pay default fees to Lendy (for its own account)*": see Webb 2 §188(d)(ii) [B/1/39] and §199 [B/1/43]. As to that:

21.1 The relevance of these provision is addressed in section (E)(i) (starting at paragraph 36) below. As a matter of construction, they do not provide any basis for saying that, as between Lendy and the lenders, it was agreed that Lendy was entitled to charge DI for its own account.

21.2 But even if they did, that would have no bearing on whether lenders were entitled to sue for DI. That different question is referable to the terms of the loan agreements, construed against the background of fact reasonably available to the parties, when they executed them: but the borrowers were not party to the Amended Model 2 Terms, and they are not part of that background.

(D) Issues 8-9: fiduciary duty and its consequences.

(D)(i) The significance of these issues for Model 2 Lenders.

22. In the agreed list of issues, the next two concern whether certain provisions in the Model 2 Terms truly formed part of the bargain between Lendy and the Model 2 lenders (Issue 6), and if so, whether they are nevertheless void, by reason of the Consumer Rights Act 2015 ("**CRA15**") (Issue 7). But since those points only arise at all if Lendy would (as Ms. Taylor maintains) otherwise have obligations to Model 2 lenders by reason of its breach of fiduciary duties, it is more logical to deal first with Issues 8-9, which concern whether Lendy owed such duties, and consequential issues of breach and remedy. Whether Lendy owed Model 2 Lenders fiduciary duties matters, because if it did, they will be able assert proprietary claims to the relevant receipts and their traceable proceeds which stand outside the insolvent estate, and this will be so whatever the outcome on Issue 5 above.

23. In her position paper, Ms. Taylor originally took the position that Model 2 Lenders were entitled to maintain such claims not only in respect of DI, but also in respect of Lendy's share of the pre-default interest, and its arrangement/exit fees (see §19.4 at [A/8/143). On the information available to her, however, Ms. Taylor now confines her case to DI only.

(D)(ii) The legal principles applicable to Issue 8.

24. For the purposes of Issue 8, the court will need to consider (1) whether Lendy occupied a fiduciary position in respect of Model 2 Lenders, and if so, (2) to what duties that gave rise. Starting with the first point, the relevant principles are as follows:

    24.1 A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence: see most recently *Children's Investment Fund v. Attorney General* [2020] 3 W.L.R. 461 (S.C.), at §44-§48, and *Company v. Secretariat Consulting* [2021] 4 W.L.R. 20 (C.A.), at §41-§42.

24.2 The relationship of agency confers upon the agent the power to affect the principal's relations with third parties, and that presumptively gives rise to fiduciary duties (*Snell's Equity* (34th ed.) §7-005, text to note 48). But even mere introducers, who have no such power, will also be fiduciaries, if and to the extent they satisfy the criterion identified in paragraph 24.1 above: see *Bowstead* §1-020 (text to note 75), and for an example, *Hurstanger Ltd. v. Wilson* [2007] 1 W.L.R. 2351 (C.A.), at §33 (a mortgage broker).

24.3 The relationship between two persons may be fiduciary as to some of its aspects, but not as to others: *New Zealand Netherlands Society v. Kuys* [1973] 1 W.L.R. 1126 (P.C.), at 1130C-E. Where the relationship is contractual, the contract "*can and does modify the extent and nature of the general* [fiduciary] *duty that would otherwise arise*" (*Henderson v. Merrett Syndicates Ltd.* [1995] 2 A.C. 145 (H.L.), at 206D (per Lord Browne-Wilkinson).

25. Turning to the nature of the duty, the "*distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary*" (*Bristol & West BS v. Mothew* [1998] Ch. 1 (C.A.), at 18A-B). Unless excluded by something in the contractual context, that basic duty then engenders a variety of more specific obligations, two of which are relied upon by Ms. Taylor as particularly relevant:

25.1 Fiduciaries "*may not put themselves in a position or enter into transactions in which their personal interest, or their duty to another principal, may conflict with their duty to their principal, unless the principal, with full knowledge of all the material circumstances and of the nature and extent of the agent's interest, consents*" (*Bowstead* art. 44, §6-046: the "**No Conflict Rule**").

25.2 "*An agent may not in breach of duty acquire a benefit from a third party without the principal's consent. The agent must account to the principal for any benefit so obtained*" (*Bowstead* art. 48, §6-079).

26. The No Conflict Rule is engaged whenever there is "*a real sensible possibility of conflict*" between the fiduciary's duty to his principal, and the competing interest or duty

(*Bowstead,* §6-047). So far as what suffices for "*full knowledge*", for the purposes of whether or not the principal has effectively consented within the meaning of the No Conflict Rule:

26.1 The principal will only be regarded as having had full knowledge if the fiduciary made "*full and frank disclosure of all material facts*": *NZ Netherlands Society* at 1131H-1132A. In *Gwembe Valley Development Co. Ltd. v. Koshy (No. 3)* [2004] 1 B.C.L.C. 131 (C.A.), that was said to require not only disclosure by the fiduciary of the fact of his profit, but also disclosure "*of its extent, including the source and scale of the profit made from his position*" (at §65).

26.2 Since what is in play is an equitable principle, the disclosure standard is flexible, and its stringency will depend on the attributes of the principal(s), and the surrounding facts more generally:

26.2.1 Thus in *Hurstanger* (see paragraph 24.2 above), it was held that there had been insufficient disclosure to a "*vulnerable and unsophisticated*" mortgage borrower who had been told that the broker stood to receive commission from the lender, but had not been told of its amount (at §36).

26.2.2 By contrast, in *Medsted Associates Ltd. v. Canaccord* [2019] 1 W.L.R. 4481 (C.A.), disclosure was held sufficient where the principals were "*wealthy Greek citizens*" and "*experienced investors*" (at §43), in circumstances where they knew the agent stood to be remunerated by the counterparty, but no further details.

26.3 But since the principal's consent operates by way of defence to a claim for breach of the No Conflict Rule, in all cases, "*the burden of proving (1) full disclosure of a conflict of interest and (2) of obtaining consent lies on the agent*" (*Bowstead* §6-039, text to note 268, with numbering added to highlight the separate elements; see further *Hurstanger* §35).

(D)(iii) Ms. Taylor's analysis of Issue 8.

27. Ms. Taylor submits that two particular features of this case point unequivocally to the conclusion that the No Conflict Rule applied to Lendy, with the consequence that it stood in a relevant fiduciary relation to Model 2 lenders.

28. First, Lendy consistently assured both lenders and prospective lenders that investments made through its platform had a high degree of protection from loss, because Lendy saw to it on their behalf that only creditworthy borrowers were admitted to the platform, and only loans with acceptable security headroom were put up on it by Lendy for investment. Highlighting only some of the more important points in the evidence, to give the flavour:

    28.1 The Lendy website included a page entitled "*How it works*" [E1/33/134]], the heading to which stated (in large print): "*we secure loans against professionally valued UK property*". So far as material, it went on:

        28.1.1 "*When a borrower approaches our parent company Lendy Ltd they begin a full and in-depth assessment of the project. Professionally qualified chartered surveyors are instructed to value the property being used as security to ensure any loan is a maximum of 70% of the Open Market Value. If the borrower and security meet the criteria the loan is secured with a legal charge …* " [E1/33/135].

        28.1.2 Under a sub-heading, "*Where is the risk?*": "*we make every effort to minimise the risks for our investors and to ensure, where possible, that all investments are repaid in full and on time. To date we have a 100% success rate with our repayments … we feel confident that we have a thorough and robust system in place to protect all Saving Stream investors*" [E1/33/136].

    28.2 Similar claims were made by Lendy in its email updates to lenders. For example:

28.2.1 The 25 August 2017 weekly update reassured them that while Lendy was "*not able to protect investors from capital loss, we do take our responsibilities very seriously … Lendy already has a robust due diligence process, which includes a five phase, multi-step (49 in fact) credit assessment overseen by our Credit Committee*" [E1/92/318].

28.2.2 An email sent on 9 October 2017 to mark what was claimed to be Lendy's fifth anniversary boasted that it was "*one of the only profitable fintech property platforms*", and went on as follows: "*but we've also managed risk carefully, and always striven to strike the right balance between loan supply and investment demand*" [E2/96/338].

29. Second, Lendy also assured lenders and potential lenders that it had robust policies in place to deal with loans that went past the contracted repayment date, and that in handling such situations, it put lenders' interests at the forefront. Again, highlighting only some of the more important points:

29.1 Having described Lendy's allegedly "*robust due diligence process*", the 25 August 2017 weekly update referred to in paragraph 28.2.1 above went on to make this further claim: "*But Lendy is not stopping there. It's committed to having the best recovery processes in the P2P industry, to help protect investors' hard-earned investments*" [E1/92/318].

29.2 Lendy's 13 April 2018 "*Investor Round-up*" email introduced investors to Lendy's new "*collections and recovery*" policy (the "**First Recovery Policy**"), stating its purpose to be "*to give our investors comfort about the robust procedures Lendy has in place to protect them in the case of the borrower's default*" [E2/112/493].

29.3 The First Recovery Policy assured lenders that they would be paid in priority to Lendy's own "*portion of interest or fees*" (see further discussion of this in section (F)(iv) (paragraph 52ff) below), and made a number of representations about how Lendy would approach situations where there was a risk of default:

29.3.1 "*Borrowers are not infrequently granted extensions to their loans … to prevent loans falling past due and to improve the position of Lendy investors who will continue to receive interest for the extended period. Lendy is careful to ensure that in granting an extension it is not increasing the risk profile of a particular loan*" [E2/111/488].

29.3.2 "*Where a borrower is unable to repay their loan in full but is able to repay their loan in part Lendy will encourage and incentivise a borrower to do this. The key benefit to partial repayment of a loan is that it enables the return of capital to platform investors and reduces the risk profile for the remaining capital by reducing the loan to value ratio*" [E2/111/488].

29.4 In an "*Investor Update Special*" emailed on 23 February 2018, Lendy then gave the following, categoric, reassurances to its lenders: "*we have never taken the support of our investors for granted, and nor shall we ever. <u>You are our number one concern</u> and protecting your interests and hard-earned capital is <u>our top priority</u> … <u>Our job is to be the champion of our investors and protect your interests</u>. And it is for this reason that we take any potential losses very seriously. Where we might be faced with a recovery shortfall, we will pursue every avenue available to us to recover investors' capital in full, along with interest accrued and any bonuses owed*" [E2/103/415].

30. So far as the management of loans post-drawdown is concerned, furthermore, it is quite clear that Lendy acted as agent on behalf of the lenders:

30.1 The point has been made above that Lendy's RAO art. 36H regulated activity of "*operating an electronic system*" was primarily facilitative. But the legislative framework also cast mandatory agency duties on Lendy which went beyond mere brokerage, as follows:

30.1.1 By art. 36H para. (1), Lendy was required (so far as presently material) to satisfy the conditions specified in para. (2A) and (2C).

30.1.2 The para. (2A) condition obliged Lendy (whether itself or by a third party) to undertake to receive payments from borrowers on behalf of lenders, and remit them to lenders.

30.1.3 The para. (2C) condition obliged Lendy (again, whether itself or by a third party) to undertake either take (a) steps to procure the payment of the borrowers' debts, or (b) exercise or enforce the lenders' rights under the loan agreements.

30.2 Reflecting the statutory framework, the Original Model 2 Terms then contained the following six terms, each creating an express relationship of agency:

30.2.1 By clause 8.1.1, lenders agreed to "*appoint Saving Stream to act as agent on your behalf in relation to the loan and instruct Saving Stream to sign the Loan Contract as agent on your behalf*" [C/14/271].

30.2.2 By clause 8.1.2, lenders further appointed SSSHL to act as security trustee, and instructed Lendy "*to sign such security documents as agent on your behalf*" [C/14/271].

30.2.3 By clause 8.1.3, lenders authorised Lendy to give instructions on their behalf to SSSHL "*in relation to the security documents and their enforcement*" [C/14/271].

30.2.4 By clause 9.6, lenders agreed that Lendy, "*in its absolute discretion … (acting as agent on your behalf) may agree with the borrower to restructure the loan and amend the Loan Contract*" [C/14/272].

30.2.5 By clause 9.8.1, lenders constituted Lendy their agent for the purposes of "*negotiating and agreeing amendments to the Loan Contract*" [C/14/273].

30.2.6 And finally, by clause 9.8.2, lenders also constituted Lendy their agent for the purpose of "*negotiating and settling any dispute relating to the Loan Contract*" [C/14/273].

30.3 All these provisions were carried-over, with minor variations (which the court can see most easily see by looking at the track changes version at [E2/107/445]), into the Amended Model 2 Terms in March 2018 [C/15/286].

31. Against that background, Ms. Taylor suggests it is as clear as it could be that Lendy stood in a fiduciary relationship to Model 2 lenders in relation to the management of Model 2 loans post-drawdown, and in particular, loans that went (or might go) unrepaid on their due date. There is nothing to displace the presumption of a fiduciary obligation that arises out of the relationship of agency constituted by art. 36H and the Model 2 Terms: on the contrary, everything points to the conclusion that Lendy could not possibly put itself into a position where its own pecuniary interests conflicted with those of its lenders in recovery situations.

32. If the Administrators' analysis of Issue 5 is correct, however, Lendy did precisely that: see the stark example put forward by the Administrators and summarised at paragraph 18.3 above, highlighting the extent to which Lendy's and the lenders' interests pulled in different directions. In any situation where a loan might go into default, Lendy stood to make substantial gains out of DI, always provided there was sufficient headroom in the security to meet its DI charges, or solvent third party guarantors able to do so. This must have coloured its decisions about when and how to take enforcement measures, with the consequence that while lenders believed (because Lendy told it so) that Lendy was their "*champion*" (see paragraph 29.4 above), its approach will in fact have been skewed by its own financial interests.

33. If the court agrees, Lendy clearly breached the No Conflict Rule, because there is no question of its having made proper disclosure to the lenders of its DI charges, and still less, of its having obtained their actual consent to them. Pending seeing what the Administrators may have to say on that point, it is necessary only to add that so far as the appropriate disclosure standard is concerned (see paragraph 26.2 above), its content

in a FSMA-regulated context will be informed by the regulatory framework, and in particular, by the material provisions of the FCA handbook. COBS 4.2.1(R) obliged Lendy to communicate in a way that was "*fair, clear and not misleading*", and it is also relevant to note the more specific obligations to give "*information on costs and associated charges*" in COBS 6.1.9(R). In failing to disclose the DI charges it was making -- at all, let alone in clear and fair language -- Lendy plainly failed to make appropriate disclosure.

(D)(iv) Issue 9.

34. If Ms. Taylor is right on Issue 8, she submits that it follows that Model 2 Lenders have proprietary claims to DI and its traceable proceeds. If the court sustains Ms. Taylor's analysis of Issue 5 and decides that Lendy collected DI for the account of Model 2 lenders, this follows straightforwardly from the fact that Lendy collected as agent and fiduciary for the lenders (see paragraph 25.2 above). If it did not, and if Lendy purported to collect DI instead for its own account, the lenders' proprietary rights flow from the fact that the monies came into Lendy's hands as the result of its breach of the No Conflict Rule.

35. The Administrators have advanced no separate reasons why this should not be so (see §38-§39 of their position paper at [A/7/82]), and it is consequently only necessary to direct the court to the controlling authority on proprietary claims to the products of breaches of fiduciary duty, being *FHR European Ventures LLP v. Cedar Capital Partners LLC* [2015] A.C. 250 (S.C.): see §50, finding in favour of "*the wider formulation of the rule*", which can be see at §30, and again at §35 ("*any benefit acquired by an agent as a result of his agency and in breach of his fiduciary duty is held on trust for the principal*").

(E) Issues 6-7: incorporation and consumer rights.

(E)(i) Do issues 6-7 even arise?

36. Having dealt with Issues 8-9, it is now appropriate to turn back to Issues 6-7. These concern various provisions in the Original/Amended Model 2 Terms which the Administrators rely upon for the proposition that Lendy was contractually entitled to charge DI for its own account, and did not thereby breach any fiduciary duty, with the consequence that Model 2 Lenders have no proprietary (or, indeed, even unsecured) claims against Lendy in respect of DI.

37. As has already been noted, this position is, in fact, inconsistent with the approach Lendy itself took, before insolvency: see paragraph 18.4 above. Be that as it may, the Administrators contend (see §35 of their position paper [A/7/80], as clarified by §2.3 of their solicitors' letter of 12 May 2021 at [D/46/136]) that it is justified by the following contractual provisions (for short, the "**Relevant Provisions**"):

    37.1 In the Original Model 2 Terms, clause 9 generally [C/14/272], and clauses 9.2-9.3 in particular.

    37.2 In the Amended Model 2 Terms, clause 9 generally [C/15/292], and clauses 9.2-9.<u>4</u> in particular.

38. Issue 6 concerns whether these terms were incorporated into the parties' agreement. If they were, then Issue 7 addresses the question whether they are enforceable, having regard to the provisions of CRA15. But before the court gets to either of those issues, a prior question arises as to whether, purely as a matter of construction, the Relevant Provisions have the consequence summarised in paragraph 36 above at all. Ms. Taylor suggests they do not, and if so, it follows Issues 6-7 do not fall for decision at all.

(E)(ii) Interpretation of the Relevant Provisions.

39. So far as that is concerned, the starting point is that the contracts between Lendy and Model 2 lenders all post-dated 1 October 2015, when CRA15 came into force:

39.1 Since Lendy was a CRA15 s.2(2) "*trader*", and Model 2 lenders were s.2(3) "*consumers*" (absent any evidence before this court that they were not: see s.2(4)), the Model 2 loans were contracts to which CRA15 was applicable, by reason of s.61(1).

39.2 This has the important consequence that CRA15 s.69(1) is applicable: "*if a term in a consumer contract, or a consumer notice, could have different meanings, the meaning that is most favourable to the consumer is to prevail*".

39.3 A "*consumer notice*", for this purpose, is defined by s.61(7)-(8) to include "*an announcement, whether or not in writing, and any other communication or purported communication*".

40. Starting with the Original Model 2 Terms:

40.1 Clause 9.4 [C/14/272] provided that "*all repayments and any interest received which is due to you will be paid to your Saving Stream account*". But the only interest that Lendy ever "*received*" from borrowers was DI, because pre-default interest was deducted by Lendy up front, prior to drawdown: see paragraph 17.5 above. Clause 9.4 thus suggests, contrary to the Administrators' analysis, that lenders were entitled to DI, to the extent any was payable.

40.2 That conclusion is corroborated, furthermore, by the terms of clause 12.8 [C/14/276]: "*you agree that* [SSSHL and Lendy] … *shall be entitled to be repaid and reimbursed out of the proceeds of any recovery under any … security and that you will pay all reasonable costs incurred by* [SSSHL] … *in enforcing the security*":

40.2.1 That Lendy was entitled only to the "*reasonable costs*" of enforcement is flatly inconsistent with the Administrators' suggestion that the rationale for its DI charge "*was to cover the costs of dealing with defaulting borrower loans*" (see Webb 2 §200 [B/1/43]).

40.2.2 It is also inconsistent with the right to make any such charge at all, particularly given the entire agreement provision at clause 24.5 [C/14/284].

40.3 Nor do the Relevant Provisions relied upon by the Administrators in the Original Model 2 Terms (*i.e.* clauses 9.2-9.3 [C/14/272]) suggest anything different. Neither expressly refers to DI at all, let alone to its being payable to Lendy, and the only basis upon which they even arguably do so (by implication) is the statement in the final sentence of clause 9.3, which runs as follows: "*the Loan Contract governs the payment of these amounts*". So far as that is concerned, there are two points to make:

40.4 First, in circumstances where lenders never got copies of the loan agreements, that sentence was wholly inadequate for the purposes of securing their agreement to DI being payable to Lendy. Having regard to clause 9.4, clause 12.8 and the CRA15 s.69(1) presumption (see paragraph 39.2 above), that sentence cannot entail the consequence the Administrators suggest, *i.e.* that Model 2 lenders agreed to Lendy keeping the DI it charged borrowers.

40.5 Second, even if it otherwise did, the final sentence of clause 9.3 constitutes a CRA15 s.61(7) "*consumer notice*", and as such, is not binding on Model 2 lenders (s.62(2)) unless it satisfies the "*requirement of good faith*" in s.62(6): but since lenders were never allowed by Lendy to see the loan contracts to which that sentence referred, it cannot possibly do. It was manifestly contrary to that requirement for Lendy to seek to bind Model 2 lenders by this oblique, and less than candid, statement.

41. Nor was the position after March 2018 under the Amended Model 2 Terms substantively any different:

41.1 The court will again find it helpful to look at the track changes version of the Amended Model 2 Terms at [E2/107/197] for this purpose. So far as clauses 9.2-9.3 are concerned, it will note that both now referred (for the first time) to

interest being payable "*to you* *<u>and Lendy</u>*": but this changes nothing. Those clauses still made no specific reference to DI, or to the fact that it was (as the Administrators claim) payable to Lendy. The new words were perfectly consistent with the fact that, as those lenders who read the website carefully will already have known (see paragraph 17.4 above), <u>non</u>-default interest was payable in part to Lendy, and in part to lenders

41.2 That point is reinforced by new clause 13.4 [E2/107/450], which the Administrators originally relied upon for the purpose of maintaining Lendy's entitlement to DI (Webb 2 §199 [B/1/43]), but which (it seems) they have now abandoned:

41.2.1 Clause 13.4 gave notice to Model 2 lenders that "*the borrower will pay default fees to Lendy (for its own account) … as described in the Loan Agreement*".

41.2.2 But interest is not "*fees*", whether generally, or more specifically in the context of the Amended 2 Model Terms: see new clause 9.11: "*details of the <u>fees</u> Lendy charges borrowers are set out in the relevant Loan Contract, and these <u>are, typically, an arrangement fee, an exit fee, and a loan monitoring fee</u>*") [E2/107/450].

41.3 No reasonable Model 2 lender reading clause 13.4 in light of clause 9.11 would have understood the reference to "*default fees*" in clause 13.4 to imply a right on the part of Lendy to charge exorbitant DI for its own account. If that is so, Lendy effectively warranted to Model 2 Lenders that its own account rights upon borrower default were limited to such "*fees*", and that is yet another pointer to the conclusion that the Amended Model 2 Terms did not, as the Administrators suggest, confer on Lendy the right to charge DI and appropriate it to itself.

(E)(iii) Issue 6: incorporation issues.

42. If the court accepts that analysis, the consequence is that Issues 6-7 simply do not arise. But against the possibility that they still may, Ms. Taylor's submissions on Issue 6 are in summary as follows:

42.1 Where one party to a standard form agreement (*i.e.* one that has not been individually negotiated) seeks to hold the other to its terms, but that other has not signed it, issues may arise as to whether individual terms within it have truly been incorporated into the parties' bargain. A given term will not have been so incorporated if: (1) it is "*onerous or unusual*", and (2) it has not "*been brought fairly and reasonably to the other's attention*" (*Chitty* §13-015).

42.2 The leading case remains *Interfoto Picture Library Ltd. v. Stiletto* [1989] 1 Q.B. 433 (C.A.), which makes clear that although this principle evolved by reference to clauses purporting to exclude the liability of one of the parties, it is of more general application. Thus, on the facts of that case:

42.2.1 A term in a standard form contract imposing a charge for failing to return bailed goods that was found to be 10 times greater than the reasonable charge (at 435B) was characterised as onerous and unusual, for the purposes of this rule.

42.2.2 Since "*nothing whatever was done by the plaintiffs to draw the defendants' attention particularly*" to the relevant provision, the court held that it "*never … became part of the contract between the parties*" (at 439B).

42.3 It is the Administrators' contention that Lendy's DI charge represented remuneration for the enhanced costs of collecting defaulting loans (see paragraph 40.2.1 above) and so far as concerns whether that represented a reasonable charge for that service, there is some helpful evidence at Webb 2 §222(d)-(g) [B/4/50]:

42.3.1 Mr. Webb explains that "*following investigation into the peer to peer sector*", the Administrators have concluded "*that 2-3% was an industry standard rate for peer to peer lending service agreements*" (§222(g)).

42.3.2 In light of that, he proposes that if the court is against the Administrators' contention that Lendy is entitled to hold on to DI, a substitute arrangement will be put in place with the SSSHL conflict administrators to cover realisation costs, whereby Lendy will charge "*3% per annum of the gross realisations from the date of default capped at a maximum of 10% of the gross realisations*" (§222(d)).

42.4 On the basis of that evidence, it is clear that Lendy's DI charge was exorbitant. The 54% aggregate rate was 18 times the "*industry standard rate*", and furthermore, was calculated – without any cap – not by reference to the monies actually realised by Lendy, but to the entire original amount of the loan. Reverting to the Administrators' own example of how DI accrued on a £2m loan (see paragraph 18.3 above), Lendy's daily DI charge of £3,068, irrespective of whether it was even taking any active steps to recover the lenders' principal, cannot possibly have been justified.

42.5 That being so, and given that (on the Administrators' case: see further Issue 10 below) Lendy's entitlement to DI is in competition with the entitlements to principal and interest of Model 2 lenders in any case where the amount realised through enforcement of the relevant security is insufficient to pay both, the Relevant Provisions had to be brought to the attention of Model 2 lenders in the clearest possible terms, if they were to be enforceable.

42.6 In the circumstances described above, they were plainly not. Far from bringing home to Model 2 lenders the scale of Lendy's claims to DI, and how it might impact their own entitlements, the overwhelming impression from the evidence is that Lendy did its very best to bury this issue. It took no steps at all to draw it to the Model 2 lenders' attention, let alone steps of the sort necessary to bring

home the point to the many of them who will have been financially unsophisticated and/or elderly.

(E)(iv) Issue 7: the impact of CRA15.

43. Issue 7 concerns the application of CRA15 to the Relevant Terms in the further (and final) alternative, *i.e.* if the court concludes that as a matter of construction, they would otherwise be apt to enable Lendy to retain DI, and if it is against Ms. Taylor on Issue 6 above (incorporation).

44. The application of the consumer rights legislation was originally proposed by the FCA, following advice from leading counsel (Richard Coleman Q.C.), which was summarised in a note [E3/167/845], and provided to the Administrators. The court is invited to pre-read that note, and Ms. Taylor adopts it as her submission on this Issue 7, subject to only the following supplemental points:

    44.1 So far as presently material, terms in consumer contracts are assessable for fairness under CRA15 s.63 unless they (1) fall within the exclusion contained in s.64(1), and (2) satisfy the criterion of transparency and prominence in s.64(2). §12-§15 of the FCA's note [E3/167/847] does not contain much discussion of the scope of the s.64(1) exclusion, and appears to proceed on the footing that the Relevant Terms fall (or at least, may fall) within it.

    44.2 Ms. Taylor does not accept this. The Relevant Terms:

        44.2.1 Plainly do not specify "*the main subject matter of the contract*" (s.64(1)(a)).

        44.2.2 Nor do they concern "*the appropriateness of the price payable under the contract*" between the trader (Lendy) and the consumer (the Model 2 lenders) (s.64(1)(b)). They relate to the charges Lendy may raise against third parties (*i.e.* borrowers) in consequence of breach of their obligation to repay on time: cf *Cavendish Square Holding BV v. Makdessi* [2016] A.C. 1172 (H.L.), at §102.

44.3 CRA15 part 1 of sch. 2 "*contains an indicative and non-exhaustive list* [the "**Grey List**"] *of terms of consumer contracts that may be regarded as unfair for the purposes of this Part*" (s.63(1)). The FCA's note does not specifically address the relevance of the Grey List, but Ms. Taylor relies on it as follows:

44.3.1 Para. 11 of the Grey List concerns terms that have "*the object or effect of enabling the trader to alter the terns of the contract unilaterally without a valid reason which is specified in the contract*".

44.3.2 This provision applies to clause 23.1 in the Original Model 2 Terms [C/14/283], and clause 24.1 in the Amended Model 2 Terms [C/15/305], both of which purported to give Lendy the right to amend the agreement "*without your specific agreement*" (the "**Variation Terms**").

44.3.3 To the extent the Administrators rely on the Variation Terms in order to rely on the amendments to clauses 9.2-9.3 discussed in paragraph 41.1 above (or indeed, otherwise), Ms. Taylor will contend that the Variation Terms do not satisfy the s.62(4) test of fairness, with the consequence that both they, and the amendments purportedly made pursuant to them, are of no effect (see s.67).

(F) Issue 10: the application of security proceeds held on trust.

(F)(i) The issue in overview.

45. From October 2015, Lendy's loans were on Model 2 terms (Webb 2 §35-§36 [B/1/8])), and its standard-form debenture (the "**Debenture**") [C/10/150] and legal mortgages (see [C/12/205] and [C/13/235]) provided for SSSHL to be the chargee/mortgagee in respect of the security granted by borrowers. So far as material:

    45.1 Clause 14.1.1 of the Debenture provided for the Security Agent (*i.e.* SSSHL) to hold its rights thereunder "*upon trust to pay and apply the same for the benefit of the Beneficiaries*" [C/10/173], which term was defined by clause 1.1 to include both the lenders and Lendy [C/10/153].

    45.2 Clause 21.1 provided that all monies received by the Security Agent pursuant to the Debenture fell to be applied first, under clause 21.1.1, towards certain charges (which are not material for present purposes), and thereafter, under clause 21.1.2, "*in or towards payment of or provision for the Secured Liabilities in any order and manner that the Security Trustee determines*" [C/10/182].

    45.3 The term "*Secured Liabilities*" was defined by clause 1.1 [C/10/156] to mean "*all present and future monies, obligation and liabilities of the Borrower to the Beneficiaries … pursuant to any Finance Document*", which was defined in turn [C/10/154] to include the loan agreements between Lendy and borrowers.

46. Clause 21.1.2 of the Debenture consequently gave SSSHL a discretionary power *qua* trustee to pay Model 2 Lenders and Lendy in whatever order of priority it chose, and it is common ground between the parties that the position is no different in cases where Lendy took legal mortgages, rather than a debenture (see Webb 2 §191(f) [B/1/42]). The issue for decision is how that discretion should be exercised in respect of funds still in its hands, in circumstances where (as will be the case in respect of many loans) there is insufficient to meet the claims of both relevant Model 2 Lenders and Lendy in full. Ms. Taylor says Model 2 Lenders should be paid in priority to Lendy; the Administrators contend they should be paid *pari passu*.

(F)(ii) What is the court's proper role?

47. Issue 10 was posed by the Administrators for the court's decision in the following general terms: "*should the Secured Liabilities be discharged pro rata … or in some other manner?*" (see §13 in the original list at [A/1/5], and §10 in the final list at [A/2/10]). This raises a threshold question about the court's role on this aspect of the application:

    47.1 A trustee upon whom a discretionary power is conferred may invoke the assistance of a court of equity in relation to its exercise: see generally *Lewin on Trusts* (20th ed.) §39-085. Among other things, he may take the decision for himself, but seek the court's blessing, in which case, the court's function is "*a limited one … once it appears that the proposed exercise is within the terms of the power, the court is concerned with limits of rationality and honesty*" (*Lewin* at §39-095).

    47.2 Alternatively, the trustee may seek to surrender his discretion to the court for it to exercise on his behalf, and this is what the Administrators in fact did here, in framing Issue 10 in the terms they did. In such a case, the court's role is different: it "*will act as a reasonable trustee could be expected to act having regard to all the material circumstances*" (*Lewin* §39-099). It exercises an originating, rather than a supervisory jurisdiction, and takes the discretionary decision for itself.

    47.3 The cases show that it is not every case in which a trustee seeks to surrender his discretion that the court will be prepared to accept that surrender: there has to be "*a good reason*" for doing so (*Lewin* §39-085(3)). But there will be such where the trustee is conflicted on the issue for decision, as is usually the case where the trustee is a company in insolvency proceedings, and the exercise of the power may benefit the insolvent estate, at the expense of other beneficiaries under the trust: see *e.g. Thrells Ltd. v. Lomas* [1993] 1 W.L.R. 456, at 459H ("*the liquidator is confronted with an impossible conflict of duties …* ").

47.4 This is such a case. The Administrators are the administrators of both the trustee (SSSHL) and Lendy, and in that latter capacity, (1) owe duties to Lendy's unsecured creditors, and (2) are themselves expense creditors in respect of their remuneration. Those duties and interests are plainly adverse to the interests of the Model 2 Lenders, in their capacities as objects of the power conferred by clause 21.1.2 of the Debenture. The Administrators cannot properly exercise their powers as the administrators of SSSHL to benefit either themselves, or Lendy's insolvent estate more generally, at the expense of Model 2 Lenders.

48. In the circumstances, the court should have no hesitation in accepting the Administrators' surrender of the discretion conferred on SSSHL by clause 21.1.2 of the Debenture. In some cases, difficulties arise, because the trustee has an intimate familiarity with the subject matter of the trust which the court can never have: there is no such difficulty here. By the time of this hearing, the court will be at least as well placed to assess the relevant considerations as the administrators of SSSHL could ever have been (cf *Lewin* §33-035, text to note 98), and resolving the issues as to the exercise of the discretion now is plainly the cost-effective course, given the other matters also standing in need of resolution.

(F)(iii) Can the discretion only be exercised in favour of a pari passu distribution?

49. If the court agrees thus far, it is convenient to deal next with a discrete issue arising out of the Administrators' PP. At §51 [A/7/85], the Administrators advanced the radical suggestion that despite the fact that clause 21.1.2 of the Debenture expressly confers a discretion in the widest terms, that discretion can <u>only</u> be exercised in favour of a *pari passu* distribution, citing *Braganza v. BP Shipping Ltd.* [2015] 1 WLR 1661 (S.C.) in support. This is plainly not so:

49.1 Nothing in *Braganza* supports the proposition that where a trustee (or any other private law decision-maker, for that matter) has a discretion to distribute a fund among a class of persons, rateable distribution is the only rational basis upon which the discretion can be exercised. On the contrary, that would be an abdication of the discretion, because the possibility of an unequal outcome is

inherent in the nature of the power: "*the very discretion conferred is to prefer one* [i.e. member of the relevant class] *over another*" (*Lewin* §29-064).

49.2 Thus, in *Edge v. Pensions Ombudsman* [2000] Ch. 602 (C.A.), a pension scheme trustee decided to exercise a power in a way that favoured one class of beneficiaries over another. The pensions ombudsman set that decision aside, claiming it breached a "*duty to act impartially between the different beneficiaries"* (at 615H), but his ruling was overturned by the High Court. Dismissing the regulator's appeal, Chadwick L.J. said: "*properly understood, the so-called duty to act impartially … is no more than the ordinary duty …* [to exercise] *the power for the purpose for which it is given … If pension fund trustees do that, they cannot be criticised if they reach a decision which appears to prefer the claims of one interest … over others. The preference will be the result of a proper exercise of the discretionary power*" (at 627E-F).

49.3 It is settled at the highest level of authority that what is true where the trustee exercises a discretionary power for himself is equally true where the court exercises it for him. In *McPhail v. Doulton* [1971] A.C. 424 (H.L.), Lord Wilberforce stated that where the court steps in to distribute a discretionary fund, it is by no means constrained to distribute it *pari passu* among the class of beneficiaries: "*equal division is surely the last thing the settlor ever intended … Equal division may be sensible and has been decreed, in cases of family trusts, for a limited class; here there is life in the maxim 'equality is equity', but the cases provide numerous examples where this has not been so, and a different type of execution has been ordered, appropriate to the circumstances*" (at 451A-B, and see further *Snell's Equity* 34th ed.), §5-012).

49.4 The Administrators PP §51(b) [A/7/85] appears to suggest that it somehow makes a difference that the trustee (*i.e.* SSSHL) is in administration, and that they (the Administrators) as a result have a "*statutory duty to treat creditors fairly*":

49.4.1 This submission neatly illustrates the point made in paragraph 47.4 above: the Administrators cannot possibly take the decision about how

the trust discretion should be exercised, because their duty to creditors (and their interest in payment of their own fees) undermines their impartiality in their separate capacity as the decision maker under clause 21.1.2 of the Debenture.

49.4.2 But it does not begin to justify the suggestion that the only way in which the court should exercise its discretion, the Administrators having surrendered it, is to direct *pari passu* distribution of the funds held on trust by SSSHL. That funds distributed from the trust by SSSHL to Lendy thereafter fall to be distributed *pari passu* by the Administrators does not entail that the trustee likewise has to distribute rateably at the antecedent stage.

49.5 The Administrators' reliance at §51(c) of their position paper [A/7/85] on clause 12.7 in the Original/Amended Model 2 Terms (see respectively [C/14/276] and [C/15/295] is misplaced. That provision did not purport to deal with how competing claims of Model 2 Lenders and Lendy would be treated, as against each other, in the event of a shortfall. It simply provided that the claims of Model 2 Lenders would abate rateably, as among themselves, if there was insufficient to go round. If anything, it consequently supports Ms. Taylor's distribution proposal, and not the Administrators'.

(F)(iv) How should the court exercise its discretion?

50. The question then becomes how the court should exercise its discretion to distribute, in place of the trustee. In the context of a traditional family or charitable trust whose assets derive from the largesse of a settlor, weight usually attaches to the wishes of that settlor (see *Lewin* §29-046). In the context of a trust like the one under consideration, it is not easy to determine who is to be regarded as the settlor for that purpose (Lendy or the Model 2 Lenders?), and nor does this court need to do so. It suffices to identify "*the main purpose*" of the settlement (*Edge v. Pensions Ombudsman* at 626G), and then to weigh the decision in light of ordinary equitable principles by reference to that purpose.

51. So far as that "*main purpose*" is concerned, Ms. Taylor submits that it was self-evidently to reassure Lenders that they benefitted from security that would see them right, even in the event of borrower default. And it is important to appreciate that this was not mere altruism: it was fundamental to Lendy's ability to raise capital that lenders believed themselves to enjoy such protection, in a competitive market where there were many other investment products on offer. Highlighting only some of the more important aspects of the evidence relevant to that point:

51.1 Powell 1 §75.2 states that he was "*always under the impression*" that Model 2 Lenders "*would recover their capital and any unpaid interest before Lendy would recover any amounts due to it*" [B/4/116], and Melton 1 §42.2 states that he similarly assumed "*that Lendy would prioritise the return of a lender's capital and interest*" [B/3/81]. Both also state that had they known their claims would be in competition with substantial claims of Lendy's own, in a shortfall situation, they would not have invested through the platform: Powell 1 97.3(d) [B/4/128]; Melton 1 §52.3 [B/3/84].

51.2 Their understandings of how Lendy proposed to deal with shortfall cases had a firm foundation. The point has already been made that clause 12.7 of the Original/Amended Model 2 Terms is consistent with Lendy not making claims against security proceeds in a shortfall case (see paragraph 49.5 above), and Lendy made unequivocal representations in its investor communications that lenders would be the priority, were that situation ever to arise: "*You are our number one concern and protecting your interests and hard-earned capital is our top priority … Where we might be faced with a recovery shortfall, we will pursue every avenue available to us to recover Investors' capital in full, along with interest accrued and any bonuses owed*" [E2/103/415].

51.3 Importantly, Lendy also made very similar claims to the FCA in March 2018, at a point at which the Authority had provisionally indicated that it was minded to refuse Lendy's FSMA part 4A application. Following publication of the Amended Model 2 Terms on its website on 4 March 2018, the FCA wrote to Lendy expressing concern that new clause 13.3 [C/15/296] subordinated lenders'

entitlements to principal and interest to Lendy's own fees [E2/108/462], and querying whether this had previously been communicated to lenders.

51.4 The FCA's communication resulted in an exchange of emails, which culminated in the following from Lendy's Head of Compliance, Paul Coles, on 16 March 2018: "*all capital payments received are apportioned* *to ensure that investors receive full repayment before settling any interest and/or costs to payable to, or paid out by, Lendy* *… Lendy has never prioritised its costs over and above those of investors in the event of a shortfall from an asset sale … Furthermore I can confirm that Lendy has absolutely no plans to change the payment waterfall to promote its costs above investors. This is a key foundation stone of our business*" [E2/109/476].

52. For the purposes of the point now under discussion, it is important to trace how that issue played out subsequently:

52.1 On 27 March 2018, Lendy published its First Recovery Policy [E2/111/486], which it announced in an investor-round up email on 13 April 2018 (see Powell 1 §77 [B/4/117], and [E2/112/492]). Consistently with Mr. Coles' 16 March 2018 email, the Policy stated that (subject to an immaterial exception) receipts from borrowers "*shall be put to the amounts owing with the following priority: (1) Capital (loan) amount; (2) interest accrued; (3)* [lender] *bonus accrual. Lendy will only take any portion of interest or fees owing to them once all of the above has been satisfied*" [E2/111/489].

52.2 That promise was inconsistent with clause 13 of the Amended Model 2 Terms, and the inconsistency was picked-up by Mr. Powell, who queried it in an email to Lendy on 30 April 2018 [E2/114/499]. This drew the following response from Lendy, a little over a week later, on 8 May 2018: "*we acknowledge the mismatch between the order of payments in our T&Cs and in the Collections & Recoveries policy. The order of payments in the event of a shortfall will be as per the Collections & Recoveries policy. We will be updating the T&Cs so that they correspond with the Collections & Recoveries policy*" [E2/114/500].

52.3 By 1 August 2018 (*i.e.* almost three months later), the promised amendment to bring the Amended Model 2 Terms into line with the First Recovery Policy had not materialised, so Mr. Powell emailed Lendy again ("*just a reminder that the T&Cs still haven't been corrected …* " [E2/114/504]). Absent any reply to that, he sent a further email on 13 September 2018 [E2/121/528], and then another one on 3 October 2018 [E2/121/530], finally getting the following holding reply: "*sorry for the delay in getting back to you. I have referred your inquiry to the legal team and I will get back to you as soon as I have an update …* " [E2/121/530].

52.4 As far as the evidence goes, that was the last communication on this point. Contrary to the assurance given to Mr. Powell on 8 May 2018, the Amended Model 2 Terms were not amended to bring them into line with (1) the First Recovery Policy, and (2) the representations made by Mr. Coles to the FCA on 16 March 2018. Instead, at an unknown date (but likely to have been after 28 August 2018: see SOAF §13.5.5(b) [A/4/45]), Lendy withdrew the First Recovery Policy, and substituted it with the Second Recovery Policy [E3194/963], which deleted the reference to lenders being repaid in priority in a shortfall case, and replaced it with the following wording: "*payments received … as a result of any enforcement action will be applied as set out in Lendy's terms and conditions*" [E/3/194/966].

53. There are the following points to make about that sequence of events:

53.1 Although the First Recovery Policy was announced in a round-robin email to lenders (see paragraph 52.1 above), the Second Recovery Policy was not. As far as the evidence goes, lenders were never told about this critical change to how Lendy proposed to proceed in shortfall cases: see further Powell 1 §79.6 [B/4/199].

53.2 The consequence of the Second Recovery Policy was that from the date of its publication, the statements on that critical point made to the Authority by Mr. Coles in his 16 March 2018 email (see paragraph 51.4 above) were misleading.

Far from prioritising lenders' entitlements, Lendy was thereafter prioritising its own, in flat contradiction to what it had given the regulator to understand.

53.3 But although Mr. Coles remained in post down to May 2019 (see Webb 2 §43(h) [B/1/11]), neither he, nor anyone else at Lendy appears to have seen fit to tell the FCA about this important change of heart. That omission would be striking enough, if viewed in isolation: it is still more so, given that on 10 July 2018, the FCA granted Lendy its FSMA part 4A full authorisation (Webb 2 §61 [B/1/14]).

53.4 In deciding to authorise Lendy, the FCA must have been influenced by the understanding (gained from Mr. Coles) that Lendy would prioritise lenders over its own claims, in shortfall cases. Lendy must have been well aware of that, and equally well aware that the FCA would look with disfavour on any attempt to derogate from that subsequently.

53.5 The facts set out above, however, suggest that while Lendy was anxious to tell both the regulator and lenders (*i.e.* Mr. Powell) that its intention was to prioritise lenders for as long as it was seeking FCA authorisation, after it got it, in July 2018, it decided to do the precise opposite, but without informing anyone of its volte face.

54. Two other aspects of Lendy's conduct towards its lenders are also relevant in this context. First, the point has already been made more than once that Lendy did not supply copies of loan agreements to investors, despite the fact that the investors were (through their agent, Lendy) themselves party to those agreements:

54.1 Taken in conjunction with clause 13.3 of the Amended Model 2 Terms and the Second Recovery Policy, the consequence of that was that in shortfall cases, lenders were exposed to a risk of loss whose magnitude they had no means of understanding. From the date of the Second Recovery Policy, Lendy's position was that its dues were payable from security realisations in priority to the amounts owing to lenders, but lenders had no means of knowing what those dues were.

54.2 The FCA made precisely this point in an email to Mr. Coles of 13 May 2018, forming part of the exchange referred to in paragraphs 51.3-51.4 above. It pointed out that because Lendy did "*not provide any information about its 'unpaid fees, costs and expenses*", lenders had no means of establishing for themselves "*the likely cost when an asset sale leads to a shortfall … we consider this to be material information that lenders should have been provided with prior to them making a decision to invest. This is information that would help a lender formulate a view as to the likely risks of losing their investment (COBS 14.3.2R(1))*" [E2/109/479].

54.3 But because of the assurances Mr. Cole gave the FCA in reply to the effect that Lendy would prioritise Investors, despite the terms of clause 13.3 (see paragraph 51.4 above), the FCA did not thereafter pursue this point, and oblige Lendy to make full disclosure to lenders of the charges the Administrators now maintain should rank *pari passu* under the SSSHL trust. The upshot is that the full extent of those charges has become clear to Model 2 Lenders only during the course of these proceedings: see the references to the evidence in paragraph 51.1 above (second sentence).

55. The second relevant aspect of Lendy's conduct is as follows:

55.1 The Administrators' evidence necessarily contains only a partial account of Lendy's no doubt extensive correspondence and dealings with the FCA. From the selected material that has been made available, however, it is clear that the Authority raised concerns that Lendy's promotional materials were misleading, and in breach of provisions in the FCA Handbook.

55.2 The Administrators have accepted in correspondence that this is likely to have been so (see the final paragraph on [D/6/15]), and there are two letters in the hearing bundle evidencing the regulator's concerns:

55.2.1 On 12 August 2016, the FCA wrote to Lendy stating that its internet advertisements "*may not meet our requirements to be fair, clear and not*

misleading, and … present a potentially misleading impression of the returns available and the nature and safety of the investments" [E1/44/160].

55.2.2 On 1 June 2017, the Authority wrote again, raising concerns over how the funding of interest payments was explained [E1/79/269], failures to flag the fact that loans being traded in the secondary market had already gone into default [E/79/271], and the claims made by Lendy about its Provision Fund [E/79/272].

55.3 Lendy's response to that first letter was particularly noteworthy. One of the FCA's principal concerns at this point was that Lendy's use of the "Saving Stream" trading name was misleading: "*you have presented a P2P agreement as a 'savings' vehicle. However, it is an investment with a very different risk profile to a savings vehicle … We consider that the use of the trading name 'saving stream' is misleading for the reasons set out above … Please reply to us in writing by 2 September 2016 telling us what you have done to change your trading name*" [E1/44/161].

55.4 Lendy replied on the 2 September 2016 deadline, initially declining to comply with the FCA's direction [E1/47/176], but an internal document dating from 1 December 2016 (Webb 2 §47 [B/1/12], and [E1/58/202]) shows that by that date, it was reluctantly bowing to pressure from the regulator, in part, out of a concern that if it did not, the "*FCA will almost certainly then, over the next 3 months, look at every aspect of Lendy Ltd's compliance with the regulator's rules …* ". On 1 March 2017, it consequently ditched the objectionable Saving Stream trading name, carrying-on business between then and administration instead as "Lendy".

55.5 Remarkably, however, when announcing this rebranding to its existing lender base, Lendy made no mention at all of the fact that it had resulted from a threat of intervention by the FCA to correct the misleading impression created by its previous trading name. Instead, it sought to explain it away with bland generalities that were, on any view, far from frank: "*following feedback from users, we are integrating the Saving Stream platform under the Lendy brand. This is in order*

to simplify the brand and make accessing the crowdfunding platform easier for all our clients" [E1/73/237].

56. Against that background, Ms. Taylor suggests that, subject to such separate considerations as arise out of Lendy's insolvency, the obviously fair course is for the court to exercise its discretion to direct SSSHL to distribute the monies it holds on trust to the relevant Model 2 Lenders in priority to Lendy. To do so would give effect to the "main purpose" of the trust (see paragraph 51 above): to do otherwise would cause hardship to a large class of individuals, many of whom will be retired (Powell 1 §85.4 [B/4/122]), and of limited means. It would also be thoroughly unconscionable to allow Lendy to participate in the limited fund, given the conduct referred to above, and in particular, the assurances it gave about priorities in order to raise capital, and secure FCA authorisation.

57. If the court agrees, the only question that leaves is whether Lendy's insolvency should make a difference. Pending seeing what the Administrators may have to say about that, Ms. Taylor makes the following points:

    57.1 Under Model 1, Lendy was itself the lender, and the chargee under the debentures it concluded with borrowers [C/2/16]. When the switch to Model 2 was made, Lendy could still have provided for itself to be the chargee, holding realisations on trust for lenders: but it did not. Instead, debentures/mortgages were thereafter concluded in favour of SSSHL, which had no separate business of its own.

    57.2 In those circumstances, Ms. Taylor suggests that it would be an odd result if the fact of Lendy's insolvency were a point of much weight in the context of SSSHL's discretion under clause 21.1.2 of the Debenture. The sole purpose of SSSHL's interposition in the structure was to serve as a bankruptcy-remote vehicle, further immunising security realisations from the consequences of Lendy's insolvency.

57.3 Reflecting that fact, Lendy's unsecured creditors are not beneficiaries under the trust created by the Debenture, and to the extent it is relevant for the court (as proxy for the trustee) to have regard to their separate interests at all, the equities as between them and the Model 2 Lenders are plainly unequal:

57.3.1 Lendy's unsecured creditors must be taken to have been content to run the risk of Lendy's insolvency. The Model 2 Lenders emphatically did not agree to that risk, however.

57.3.2 While there is no evidence of the hardship which a subordination of Lendy's claims may occasion to its unsecured creditors (or indeed, much evidence as to who those unsecured creditors may actually be), the likelihood of hardship to Model 2 Lenders if Lendy's claims rank *pari passu* is evidenced, and indeed obvious.

22 June 2021