Lendy & Saving Stream Security Holding Ltd

Day 4

July 1, 2021

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Thursday, 1 July 2021

(10.58 am)

THE CLERK OF THE COURT: This is in the matter of Lendy Ltd and Saving Stream Security Holdings Limited, case number CR-2019-BHM-000443 and 444.

Can I remind parties that they should be in a private, quiet area if possible so that you are not overheard and can hear. Whilst this hearing is being recorded by HMCTS, you must not make any personal or private recordings or publish any part of this hearing. It is a criminal offence to do so.

Thank you.

HIS HONOUR JUDGE RAWLINGS: Unlike every other day, I'm not aware of any preliminary points we need to deal with. Is there anything?

MS TOUBE: No, my Lord we are straight on to issue 10 now.

HIS HONOUR JUDGE RAWLINGS: Okay, fine.

Submissions on Issue 10 by MS TOUBE

MS TOUBE: Issue 10 is a question which the administrators ask with their SSSHL hat on. So they ask administrators of that company.

And your Lordship will know that this is an issue that arises in relation to the Model 2 Debenture. So we need to start by taking that document up. It's at bundle C, tab 10. Now I should say there were both

debentures and then there were legal mortgages. Nothing turns on the terms of the mortgages so we only need to look at the debenture.

And we start with clause 14 of the debenture at 173, and that provided for the security agent, that's SSSHL, to hold its rights, and you'll see at the bottom of 14.1.1:

"... upon trust to pay and apply the same for the benefit of the Beneficiaries in accordance with their respective entitlements under the Finance Documents subject to and in accordance with the terms thereof."

So the first question is who are the beneficiaries, and we see that from page 153, and the beneficiaries are the lenders, SSSHL, and then Saving Stream, that's Lendy, a receiver and delegate. We don't need to worry about those words.

And then we ask what are the finance documents, that's at 154, and you'll see that those include the loan agreement.

Going back in the document to page 182, we see clause 21 which relates to the application of proceeds, and that's where the issue in particular that we're looking for arises.

So all monies received by SSSHL, pursuant to this deed:

"... after the security constituted by this deed has become enforceable, shall [we can ignore the brackets] ... be applied in the following order of priority ..."

Now the first is all costs, charges and expenses incurred by or on behalf of the beneficiaries, the security agent etc under and in connection with this deed and of all the remuneration due to any receiver. You can ignore that.

So the first point is, it is clear that what comes out first are all costs, charges and expenses incurred by or on behalf of Lendy and the Model 2 investors relevantly but also SSSHL.

Now those will include the costs of enforcement, which in this case involves all sorts of things in relation to enforcing the security against the borrowers. So that may be quite a large chunk of costs which come out first.

Then we get to 21.1.2:

"... in or towards payment of or provision for the Secured Liabilities in any order and manner that the Security Agent determines ..."

And "Secured Liabilities" is defined at 156:

"All present and future monies, obligations and liabilities of the Borrower to the Beneficiaries ..."

So again to Lendy and to Model 2 Investors:

"... whether actual or contingent and whether owed jointly or severally, as principal or surety or in any other capacity together with all interest (including without limitation, default interest) accruing in respect of those monies, obligations or liabilities pursuant to any Finance Document ..."

Finance document, again including the loan agreement.

So the question that arises in this issue is when clause 21.1.2 says that SSSHL can pay or provide for the secured liabilities in any order or manner that the security agent determines, how should that discretion be exercised? And in essence what we say is SSSHL is in administration. In administration when it has liabilities which are owed to different people. Different creditors. It should pay them pari passu.

HIS HONOUR JUDGE RAWLINGS: Yes.

MS TOUBE: So, it shouldn't prioritise the Model 2 Investors over those creditors in its general estate.

HIS HONOUR JUDGE RAWLINGS: Yes, but none of these are creditors in its estate, they're in the estate of Lendy, if --

MS TOUBE: No, that's correct, but Lendy is one of its creditors as well.

HIS HONOUR JUDGE RAWLINGS: SSSHL's creditors?

MS TOUBE: Yes. Yes.
HIS HONOUR JUDGE RAWLINGS: For what?
MS TOUBE: Well, for the costs apart from anything else, but also for the inter−company liabilities. And it, as a company that's in administration which is holding these monies for its beneficiaries, which are Lendy and the Model 2 Investors, the Model 2 Investors are also not its creditors in any real sense.
HIS HONOUR JUDGE RAWLINGS: No, they're not, no. In respect of the money that it is exercising a discretion over, and obviously it isn't exercising discretion any more, I am, the actual monies it is exercising a discretion over, none of those would go to SSSHL's creditors as (inaudible). That's the whole point of having a security trustee, because it is deciding how monies that don't belong to it, and in respect of which it owes no liability, should be distributed.
MS TOUBE: Yes, that's correct.
The first question we get is: how does the court have jurisdiction to determine this question?
It's common ground, I should say, that the court does have that ability to determine the question.
The Model 2 Investors say that Lendy, or SSSHL, is surrendering its discretion to the court. That's not in fact quite the right analysis. In fact, the question

being asked by SSSHL's administrators is not, "Please can you exercise my discretion?", but, "Can the discretion be exercised as a matter of general legal principle in any way other than the way in which we suggest, and if so, what should those principles be?"
So it's not strictly a surrender of discretion.
Now, that doesn't hugely matter to your Lordship, because the question we're asking is the same question, which is: what are the principles by which that discretion should be exercised?
HIS HONOUR JUDGE RAWLINGS: So you're characterising it as, plain and simple, an application by administrators for directions as to how they exercise the SSSHL discretion, rather than the surrendering of the SSSHL discretion as trustee to the court. It's not a trustee asking the court to exercise the discretion; it's the administrators asking how it should exercise the discretion.
MS TOUBE: Yes, it's asking what are the legal principles we should apply when we are exercising our discretion.
HIS HONOUR JUDGE RAWLINGS: Okay. All right.
MS TOUBE: But as I say, it doesn't matter because the real question is, what are those principles?
So the first point we make is that the discretion which is being exercised by the administrators must be

exercised honestly and in good faith. And in this respect, we rely on the Braganza case which we refer to in paragraph 152 of our skeleton. And it will be worth just turning that up. It's in authorities bundle 2, tab 32, page 882 and we start at paragraph 18. Can I just invite your Lordship to read paragraphs 18−20.
HIS HONOUR JUDGE RAWLINGS: Yes, okay. It probably goes nowhere, but this talks about a clear conflict of interest, and I understand within the context of the Braganza contract where that clear contract of interest is, but in the case of SSSHL, there wouldn't be a conflict of interest or shouldn't be because that's the whole point in putting SSSHL there. I'm not sure it goes anywhere.
MS TOUBE: I think the point is the conflict of interest is both Lendy on the one hand, and the Model 2 Investors on the other hand, want to be paid first.
HIS HONOUR JUDGE RAWLINGS: Yes.
MS TOUBE: In fact what Lendy says is you should pay us equally at the same time but the Model 2 Investors say, no, no, you should pay me first.
So there is a conflict of interest between the two of them. SSSHL is saying: well, which one of them should I pay?
HIS HONOUR JUDGE RAWLINGS: All right, well, I think I'll

answer that. I think the conflict of interest there referred to is about the conflict that one party to a contract has in making the decision in that it may be in its interests to exercise it in one way or another. But actually having thought about it, because SSSHL is at least a sister company of Lendy, there is at least the appearance of a conflict of interest there in wanting to prefer Lendy potentially as a sister company owned by the same parent. I probably answered my own question, but carry on.
MS TOUBE: Yes, I don't think that we're strictly in Braganza case where the trustee −− where SSSHL itself cares which of these gets it. The conflict is between the beneficiaries in this case.
HIS HONOUR JUDGE RAWLINGS: Yes.
MS TOUBE: The position, of course, for the underlying creditors of Lendy is going to be much more −− of much more interest.
But the point I was really getting to is in paragraph 20, was the quotation from the Abu Dhabi case, so that when that discretion is being exercised, it has to be exercised honestly and in good faith:
"'... but, having regard to the provisions of the contract by which it is conferred, it must not be exercised arbitrarily, capriciously or unreasonably.'"

So the point is the discretion isn't at large; it's got to be exercised in a way which is honestly and in good faith.

Then we say, well, SSSHL is of course in administration, and they have a statutory duty to treat their own creditors fairly. And it would naturally be the case in an administration that creditors should be treated pari passu, but we also draw attention to the general pro rata principle in the underlying documents. So as between Lendy and —— as between the lenders and others.

So I should say paragraph 12.7, which we draw attention to in 152.3, as we point out, does not deal with the allocation of the recoveries between the Model 2 Investors and trustees/transferees in Lendy, but it does talk about the concept of proportionate share. I don't think I need to take you to 12.7, because we set it out in that paragraph.

HIS HONOUR JUDGE RAWLINGS: Okay.

MS TOUBE: Then, we say well, what are the arguments that are made to say that, in fact, the Model 2 Investors should be paid out first? And all of those arguments really depend on extraneous bits of correspondence which I'm sure my learned friend will take you through. I'll take you through some of them now. And it's the

question of what Lendy was saying to the Model 2 Investors, and what Lendy was saying to the FCA.

And we start in paragraph 154 by dealing with the most troublesome of these documents vis—a—vis the FCA, which is the document which is dated 16 March 2018. And again, I don't think I need to take you to it because we set it out in detail, but you'll see that what Lendy was telling the FCA was that all capital payments received would be apportioned to ensure investors received full repayment for settling any interest or costs payable to or paid out by Lendy.

HIS HONOUR JUDGE RAWLINGS: Yes.

MS TOUBE: And as we point out in our paragraph 155, although it is no doubt the case that Lendy was telling the FCA this, it appears not to have told the investors this. We make that point in paragraph 156. So again, I think it is fair to say that Lendy's dealings with the FCA were not accurate, candid or any of those other things. But that doesn't tell you how SSSHL should exercise its discretion.

And of course we know from the amended Model 2 Terms, as your Lordship knows, that there was a waterfall which came in under clause 13, and I will come back to what happened around this, but we should start with looking at this.

So we look at tab 15 and page 296. And your Lordship will see that under that waterfall, Lendy, acting as agent on behalf of each lender and SSSHL, shall enforce payment of the debt and enforce the security against the borrower. And lenders don't have rights to enforce the security directly except via Lendy or SSSHL.

And then we get 13.3:

"In the event of a shortfall in the amounts available for repayment of the Loan, the available ..."

[VC poor connection; visual/audio freeze]

HIS HONOUR JUDGE RAWLINGS: Sorry, Ms Toube, you just froze for a few moments there, so I didn't hear what you said after referring to 13.3.

MS TOUBE: I was just —— actually just reading it out. So I haven't said anything more than what is in there.

HIS HONOUR JUDGE RAWLINGS: Okay, that's fine.

MS TOUBE: Just drawing attention to the fact that the accrued interest fee or commission under the loan agreement comes out before the principal under the waterfall. That's what the terms say. And no matter what Lendy was saying to (inaudible) or indeed (inaudible) in other documents, this is what its lender terms actually said.

The other point just to make, before we look at

these documents, the FCA e—mail to which my learned friend just referred in paragraph 154 of our skeleton is (inaudible) March 2018 obviously is at a relatively late date.

HIS HONOUR JUDGE RAWLINGS: Ms Toube, unfortunately we are missing some of what you're saying, unfortunately. Can I just suggest that sometimes it does fix it if you leave and join again, I'm sorry to say but sometimes that does ——

(Off the record discussion re VC connection)

(Pause)

MS TOUBE: Can you hear me better?

HIS HONOUR JUDGE RAWLINGS: Yes.

MS TOUBE: So what we have here is a shortfall in this trust, and the question is how we should be applying the shortfall in the trust. So it's an insolvent trust run by administrators of an insolvent company, and the question is how we should distribute, and I was just taking your Lordship through the principles, and I think we were just looking at, if you heard me, I hope, clause 13 of the amended model terms.

HIS HONOUR JUDGE RAWLINGS: I think you had read out 13.3, and that's about as far as we got. We heard.

MS TOUBE: And I was just making one point in relation to the FCA e—mail, which was the FCA e—mail of 16 March,

and what is said is that this is effectively governing in some way or evidence in some way of how these items should be distributed, and I said to your Lordship that this had not been, as far as we know, circulated to the investors. And also, it post-dated most of the loans that we were talking about, and I was about to show you Mr Powell's position, for instance.

And if we look at his witness statement in bundle B, tab 4, at paragraph 46. If I can just invite your Lordship to read the beginning of that paragraph. And here Mr Powell is explaining why he was reducing his investments. But you'll see from the very beginning of that paragraph that he started doing that in early 2018. So prior to this date of the FCA e-mail.

So then we say, well, how does all of this work in terms of a chronology of the other documents that were out there? And we deal with this in paragraph 157 of our skeleton. And first of all, we draw attention to the first overdue loans default policy. I don't need to take you to that because there is nothing in there at all about the order in which things should be paid out.

Then we get the second overdue loan default policy. Again, there is nothing in there telling us in what order these should be paid out.

Then we get to the recovery and collections policy which we refer to in 157.3. That, I think, your Lordship saw yesterday but we should look at it again. It's in bundle E2, tab 111. And if your Lordship looks at page 489, you will see the priority of payments provision.

Now this document was effective from 13 April 2018. It was published on 27 March 2018. And it did say that the investors would be paid before Lendy. Now, the oddity of that is that as your Lordship knows, it was inconsistent with the terms of the amended Model 2 Loans. The investment terms.

And we know that Mr Powell picked this up. And we know this from again bundle E2, tab 114, page 499, and we see that Mr Powell says: well, can you explain the discrepancy between clause 13.3 and the terms and conditions and the priority of payments in that document? And the response to that comes from Lendy, over the page at 500, saying: yes, we acknowledge there is a mismatch between the two of them and the terms and conditions will be amended.

So if that is where it had stopped, that would have been clear. But in fact the amended Model 2 Terms were not amended, and so Mr Powell e-mailed again and we see that at page 504, and he says:

"Just a reminder that the [terms and conditions] ... still havent been corrected ..."

He then doesn't get a response to that, and he responds again, which we see at tab 121, and he says on 13 September:

"Still wrong, and even worse, cut and paste into the Wealth terms as well. Are you really this incompetent that you cant correct an error in a legal document after 5 months?"

He sends a further e-mail, still no response, on page 530 on 3 October, and he says:

"Seriously? A cut and paste of the previous answer from 5 months ago. Still not fixed. So completely incompetent at customer service and legals.

"So how do I escalate this to a complaint ..."

HIS HONOUR JUDGE RAWLINGS: Yes.

MS TOUBE: Then he gets a response to that which says:

"I have referred your inquiry to the legal team and I will get back to you as soon as I have an update, in the meantime, we thank you for your patience."

And that's it. It's common ground that the amended Model 2 Terms were not amended, and in fact what then what happens is that there is a second collections policy and this one is in bundle E3, tab 194. Now, this we don't have a date for, but it's some time

between April and August, 2018. I believe that the statement of agreed facts says it was probably post-August 2018, so it's quite late and it was uploaded to the website, although again we don't know exactly what date that was. And it makes it absolutely clear at 966 under "Priority of payments":

"Payments received from a borrower or as a result of any enforcement ... will be applied as set out in Lendy's Lender terms and conditions."

So whatever Lendy was telling the FCA, its amended terms and conditions said that the priority was as set out there. And it had an amended recovering collections policy which said those terms governed. And despite Mr Powell's having picked up the point and Lendy saying, "Oh, yes, we have it wrong, we'll amend our terms and conditions", they didn't. In fact they expressly did the opposite, which is to say terms and conditions still applied.

HIS HONOUR JUDGE RAWLINGS: So as I understand it, nobody is suggesting that any of this has any contractual force, and nobody is basing a claim on representation. I know that Mr Gledhill places some reliance on it and he'll come to it. But your position, as I understand it, Ms Toube, is that this is really not pertinent to the question of how the discretion should be exercised.

MS TOUBE: Yes. The reason I'm dealing with these points is to deal with what is said by my learned friend, which is it should be dealt with differently because these documents say something different. And what I'm saying is, well, the documents are a mess, to put it mildly, but they certainly end up with a position which says the opposite of what the Model 2 Investors would like it to say.
HIS HONOUR JUDGE RAWLINGS: Okay. So in principle, Mr Gledhill may say, but if I put it in potentially clear terms, I think he is saying: look, Lendy is a beneficiary of this trust and there is conduct here on the part of which is unethical or contrary to what it promised to the FCA and all the rest of it, and that conduct of a beneficiary can be relevant to the exercise of the discretion here.
Is it your case that conduct of a beneficiary can't be relevant to the exercise of discretion?
MS TOUBE: Yes, that is our case.
HIS HONOUR JUDGE RAWLINGS: All right. Thank you.
MS TOUBE: So when we're looking at what the trustee should do, a trustee of an insolvent trust, the trustee itself in administration, it should divide the shortfall pari passu and our point is really as simple as that.
HIS HONOUR JUDGE RAWLINGS: I think it's probably also your

case that in the widest sense, fairness doesn't, or perhaps it does. I think perhaps you say that pari passu is the only fair way in which it can be distributed, is that right?
MS TOUBE: Yes. We say it's fair, it's appropriate, it is the governing principle where you have an insolvent entity and here we have an insolvent trust.
HIS HONOUR JUDGE RAWLINGS: Do you?
MS TOUBE: Well, there are shortfalls. So the trust does not have provision ——
HIS HONOUR JUDGE RAWLINGS: Well, perhaps. I suppose that the trust might also be in a sense limited recourse, in the sense that it has a chunk of money and it's just doling it out as appropriate. I'm not entirely sure that the trust can be said to be insolvent. I know it's short of what it would like to have in order to ensure that everybody got everything to which they are entitled. But is it insolvent?
MS TOUBE: Well, there are certainly shortfalls as against the realisation of the security, and to that extent, there is not sufficient within the trust to make payment to all the beneficiaries in full.
HIS HONOUR JUDGE RAWLINGS: For what they'd like to receive, yes.
MS TOUBE: Well, for even what they're entitled to receive,

ultimately.
And so the point about Lendy's conduct is that as between beneficiaries, there might be claims which can be made —— and I have said this before, there might be claims which can be made by the Model 2 Lenders against Lendy in Lendy's administration for misrepresentation or for whatever else, but Lendy itself is now in an insolvency, and so Lendy, of course, for all intents and purposes, is Lendy's unsecured creditors. So the effect of what is said by the Model 2 Investors is that because of misrepresentations which it says were made to it ——
HIS HONOUR JUDGE RAWLINGS: Or to somebody.
MS TOUBE: —— or to somebody, to some or more of the Model 2 Investors —— Lendy's other creditors should be denied a recovery into Lendy's estate. So HMRC, as your Lordship has seen, is a creditor. The Model 1 Investors. Indeed, Model 2 Investors for their own shortfalls. So there will be all sorts of creditors in Lendy's estate. So punishing Lendy in the way in which the Model 2 Investors would no doubt wish to do, no longer, once Lendy is insolvent, has the effect that they would like it to have.
HIS HONOUR JUDGE RAWLINGS: Yes, but that sort of comes back to your submission or position that the conduct of the beneficiaries is not relevant to the exercise of the

discretion.
MS TOUBE: Yes. So my point is, the conduct of the beneficiaries is not relevant to the exercise of the discretion, and even if it were, in circumstances where Lendy is insolvent, the conduct of Lendy pre—insolvency is cannot be used post—insolvency for the exercise of discretion where it would penalise Lendy's creditors.
HIS HONOUR JUDGE RAWLINGS: Okay.
MS TOUBE: And the same point would run in relation to questions of: oh, is it fair? Well, whatever might have been the position prior to Lendy's insolvency, after Lendy's insolvency, where Lendy's assets are held on the statutory trust for its creditors as a whole, it would be unfair, should that be a question that's of any relevance, to penalise Lendy.
HIS HONOUR JUDGE RAWLINGS: One of the points Mr Gledhill says is you need to look at the main purpose of the trust. And the main purpose of the trust is to ensure the Model 2 Investors get paid. Therefore the exercise of discretion, as I understand it, should give effect to that main purpose of the trust and ensure that Model 2 Investors get paid so far as possible. What about that?
MS TOUBE: Well, in relation to that, it is true that a purpose of the trust was for Model 2 Investors to be paid. But it was also a purpose of the trust for Lendy

to be paid in relation to its costs and interest. And we know that partly from the naming of Lendy as a beneficiary, and from the waterfall, which we've seen in the Model 2 Loans.

HIS HONOUR JUDGE RAWLINGS: Yes.

MS TOUBE: And generally from the provisions of the Model 2 loan itself, the underlying loan which was capital interest fees, etc. So the main purpose of the trust is to distribute the proceeds of realising the security in accordance with the waterfall. And then the question is: well, what is that waterfall, in circumstances where we are now where we are factually.

HIS HONOUR JUDGE RAWLINGS: So the purpose of the trust is important, but the purpose of the trust is to distribute to the beneficiaries, with no particular priority being given to the Model 2 Investors.

MS TOUBE: Yes.

HIS HONOUR JUDGE RAWLINGS: Okay.

MS TOUBE: So, my Lord, those are my submissions in relation to issue 10.

HIS HONOUR JUDGE RAWLINGS: Yes, all right, thank you. Mr Gledhill?

Submissions to Issue 10 by MR GLEDHILL

MR GLEDHILL: My Lord, can I start by clearing two short points out of the way. The first is one point, the

suggestion is made by my learned friend that the trust is insolvent. The trust is not insolvent. The trust is there to provide a fund to discharge various liabilities owed to Lendy and to the lenders by third parties by the borrowers. The trust has insufficient monies to discharge those funds in full. It does not entail that the trust is insolvent. It merely entails that the trustees are going to have to take a discretionary exercise of power to decide who gets paid what out of the available pot.

The second point. At one point in her submissions, at an earlier point in her submissions, my learned friend suggested that the trust secures monies generally owed by Lendy, by SSSHL to Lendy, and that is incorrect. Your Lordship expressed some unease at that proposition. The answer to it is apparent if you turn up the debenture in the C bundle at tab 10, and remind yourself of what the trust secures.

It's a provision that Ms Toube in fact showed you at the bottom of C173:

"Security Trust

"14.1.1. The Security Agent shall hold and administer all the rights benefits and interests constituted in its favour by or pursuant to this Debenture ..."

Pick it up three lines from the bottom:

"... and apply the same for the benefit of the Beneficiaries in accordance with their respective entitlements under the Finance Documents ..."

And we saw the definition of "Finance Documents" at C154. "Finance Documents" means the loan agreement and the security agreement and all the agreements entered into between Saving Stream and the borrower.

So it is simply incorrect to say that this trust is in Lendy's favour in its capacity as a creditor of SSSHL. It is in its favour as a creditor of the underlying borrowers.

My Lord, I'm going to start my more general submissions on this topic by taking a little time going through the aspects of the factual background which we suggest to be particularly relevant.

Your Lordship knows from the evidence that Lendy launched its online platform in February 2014, and that in the period between 2014 and the second half of 2015, it operated under the Model 1 structure. Webb 2, paragraphs 29–31, bundle reference B, tab 1, page 7, don't need to take you to it, tells us that in March 2015, Lendy commissioned Grant Thornton to prepare a regulatory report, and that report identified, among other things, a concern that because lenders were

lending to Lendy under Model 1, and Lendy was then lending to borrowers as principal, Lendy's arrangements were not truly those of a peer–to–peer lender.

And that appears to have been what precipitated the shift to Model 2 later in the year, and the evidence in the bundle tells you that Lendy announced the change from Model 1 to Model 2 in an e–mail to investors of 21 September 2015. That's bundle E1, tab 9, page 81.

Down to that point, when Lendy took security for loans, reflecting the fact that it was the principal vis–a–vis the borrower, it took the security in its own name. It was the chargee. And just for your note, there is a relevant debenture in the bundle at file C, tab 2, page 16.

HIS HONOUR JUDGE RAWLINGS: Yes.

MR GLEDHILL: But as part of the shift to the Model 2 arrangement, SSSHL was set up and Webb 2, paragraph 34, tells us that SSSHL was incorporated on 17 August 2015. So very roughly a month before the shift to Model 2 was announced to investors on 21 September 2015.

The evidence tells us that SSSHL's two shareholders were the two founders of the business, Mr Brooke and Mr Gordon. So far as the evidence goes, SSSHL had no separate employees, and no separate business other than to act as the security trustee vehicle. And your

Lordship saw yesterday afternoon, I took you to clause 8.1.3 in the Model 2 investor terms, both in the original and the amended, which shows that SSSHL, unsurprisingly, took its orders from Lendy.

In our skeleton argument, we made the point to your Lordship that even after Model 2 was introduced to create a true peer—to—peer relationship, Lendy could have continued to take security for the lender's loans from borrowers and declared itself to be a trustee of that security.

So that begs the question: why was it necessary to put SSSHL into the structure? And my Lord finds the answer to that question, if you now take out bundle E3, and turn up tab 179, you can see the heading, "New P2P Trust Structure". This is the announcement I mentioned a moment ago. It is an exhibit to Mr Powell's witness statement, paragraph 39, and this is the announcement that dates from September 2015. And by and beneath the second hole punch, you can see the material passage under the heading in capitals, "New Structure":

"When you invested in a loan, we kept detailed records of this, but an administrator may consider it a pari passu risk ... in the event of Lendy 'Ltds (highly unlikely) bankruptcy."

Just note the words there, "Lendy Ltd's (highly

unlikely) bankruptcy".

"One bad loan, could in theory undermine the rest.

"When we become a Pure P2P platform, you lend to the borrower via Lendy Ltd and a 'nominee company' called Saving Stream Security Holding Ltd, holds the security on your behalf. The purpose of the nominee company is to manage the investment on behalf of all the Lenders so that the borrower only has to deal with a single entity rather than '1000s of individuals ...

"This mitigates bankruptcy risk and the contagion of one bad loan will not affect the others."

Now, I emphasised in the first paragraph the reference to Lendy Limited's what was called "highly unlikely" bankruptcy, and so when you read in the third paragraph that the point of SSSHL is to mitigate bankruptcy risk, what this document is telling you is that the purpose of the interposition of SSSHL in the structure is quite specifically to protect Model 2 Lenders from the risks presented by Lendy's own bankruptcy.

And it's also relevant for your Lordship's purposes to note the way in which SSSHL's position is described in two lines in that second paragraph. It is described as a nominee. A bare trustee. So investors are being told that SSSHL is a bare trustee for them of the

security in respect of their loans to the underlying borrowers.

But as your Lordship knows, and not for the only time, Lendy did something rather different to what it told the investors it was going to do. Because having told investors that SSSHL would simply be a bare trustee, it then put in place the debenture that your Lordship has seen which provided for its own claims to be secured, and which also conferred on SSSHL a discretion as to the order of payment.

And if you create a trust and give the trustee a discretion, you have of course not created a bare trust or a relation of nomineeship. A bare trustee does not have any discretion; he or she simply holds the legal title to the asset to the order(?) of the principal.

Your Lordship knows that in the period after Model 2 was introduced in September 2015, Model 2 arrangements were governed by the original Model 2 Terms down to March 2018, when the amended Model 2 Terms came out.

The evidence tells us that towards the end of the original Model 2 period, some of the loans started to go into default.

HIS HONOUR JUDGE RAWLINGS: Which is your Model 2 vehicle? You mean before the new Model 2 Terms are brought in.

MR GLEDHILL: Yes. Forgive me, the original terms are in effect between September 2015 and March 2018, and the point I'm making to your Lordship is that towards the end of that original Model 2 period, some of the loans started to go into default, and the consequence of that was before the lender terms were amended, Lendy started to give investors assurances about how they could expect Lendy to act in the event of a shortfall situation.

And the clearest of those is the one that your Lordship finds if you put away bundle E3 for the moment and turn now instead to bundle E2. And it's at tab 103. Page 414. This is another document exhibited by Mr Powell. It's referred to in paragraph 91 of his witness statement. And it dates from 23 February 2018, so it's still during the currency of the original Model 2 Terms. And over the page at page E415, you see at the top of page E415:

"We have never taken the support of our investors for granted, nor shall we ever. You are our number one concern and protecting your interests and hard—earned capital is our top priority. Unfortunately, on the rare occasion when a property does not reach its expected sale price it can potentially cause harm to our reputation, which in turn can damage our own balance sheet and profitability.

"Our job is to be the champion of our investors and protect your interests. And it is for that 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."

HIS HONOUR JUDGE RAWLINGS: Yes.

MR GLEDHILL: And just while we're there, you might as well note the last two lines on the page under the heading, "Final":

"A firm's approach to recovery will have a huge bearing on the health of a loan and we have long understood the importance of this."

So this is reassuring investors under the original Model 2 Terms that Lendy's top priority in the event of a shortfall situation is to protect their interests and their hard-earned capital. So far so good. But as your Lordship knows, then in March 2018, the amended terms come out. And if you turn on within the E2 bundle to tab 107, you will find the track change version that I took you to earlier that shows the main differences between the original and the amended terms.

HIS HONOUR JUDGE RAWLINGS: Which bundle are we in?

MR GLEDHILL: Still in E2, tab 107. And within that tab, if

you turn on to page 450, you can see the key difference, what's changing in these Model 2 Terms as regards shortfall situations is the new provision you see at 13.3. I'll just read that:

"In the event of a shortfall in the amounts available for repayment of the Loan, the available proceeds will be paid [note these words] in the order set out in the Loan Agreement, as follows: first, payment of any unpaid fees, costs and expenses of the Agent under the Finance Documents; second, payment of any accrued interest, fee or commission due but unpaid under the Loan Agreement; third, payment of any principal ... fourth, payment of any other sum ... under the Finance Documents. However, Lendy may, and Saving Stream Security Holding may, vary this order in their discretion."

It's worth noticing in passing that even the terms of clause 13.3 were a misrepresentation of the correct position. Those words that I emphasised when I read it out to you, "the available proceeds will be paid in the order set out in the Loan Agreement"; the loan agreement doesn't say anything about priority. Nor in fact does the debenture.

What this was purporting to do was to suggest that actually there had been continuity all along, and that

this wasn't changing anything; it was simply reflecting what was in the loan agreements and the debenture. And that was untrue.

HIS HONOUR JUDGE RAWLINGS: I suppose in a sense it wasn't changing anything because it wasn't Lendy's discretion to decide how things were paid in the event of a shortfall; it was SSSHL's discretion.

MR GLEDHILL: Yes, nominally, the same people.

HIS HONOUR JUDGE RAWLINGS: I know in a sense the respect in which you want to rely on it, but is this not in effect -- let's ignore for the moment that Lendy was probably telling SSSHL what to do -- is this not rather irrelevant, given that it was SSSHL's discretion as to the order in which things were paid, and Lendy was suggesting that it wasn't or wouldn't be?

MR GLEDHILL: It is irrelevant as a matter of legal analysis to the question which your Lordship has to decide. It is a point of some importance, for the reasons I'm coming on to, in understanding what happened thereafter.

HIS HONOUR JUDGE RAWLINGS: Yes.

MR GLEDHILL: Just while we're on this document, I did just want to show you clause 12.7, which is the one over the page. Back over the page at 449. There was some reliance placed on this in my learned friend's skeleton argument. If you look at 7 in the middle of the page,

just above the first hole punch, it's talking about the shortfall situation. And it says:

"If that is the case ..."

Do you see those words:

"... then the lenders shall only be entitled to recover their proportionate share of such available proceeds."

And the suggestion was originally made in my learned friend's argument that that was a flag for the fact that lenders would have to share pari passu with Lendy under the SSSHL trust. And we made the point in our skeleton argument, it simply does not say that. What it is telling the reader is that if there are 100 investors in a given loan, they share rateably according to their participations in the loan. It's saying absolutely nothing about Lendy's entitlement to share under the SSSHL trust. I just mention that in passing. My learned friend didn't place any great weight on that in the context of her submissions.

So that was the change, the key change, clause 13.3 made in March 2018. How did the investors react to that?

And there is some quite important evidence about that in Mr Powell's witness statement, which I'd like to take you back to in the B bundle at tab 4.

HIS HONOUR JUDGE RAWLINGS: I'll make a point which probably again goes nowhere —— probably tired of making points that go nowhere. If clause 13.3 can be taken to say all sorts of useful things that are irrelevant, apart from the final sentence, which says:

"However, Lendy may, and Saving Stream Security Holding may, vary this order in their discretion."

That's not true either. Only Saving Stream Security Holdings could. Does it, in a fine analysis, actually contradict what Lendy was —— necessarily contradict what Lendy was saying to the FCA, because it might be saying: oh yes, well of course we'll always exercise our discretion, even though we haven't got one, in favour of preferring the position of the M2 lenders, as we told the FCA.

MR GLEDHILL: That's exactly what they do tell the FCA, and then they surreptitiously renege on it. And just so your Lordship knows where I am going, a suggestion is made to your Lordship that the representations made by Lendy are relevant to the discretionary exercise which is going to be conducted under this test (?) and we suggest that that is plainly wrong. It is a highly relevant consideration. I'll come back to that later on.

But I'm going to come on to the exchange with the

FCA in a moment. I just wanted to start it off just by showing you what the immediate reaction was on the part of the lenders, and there is some relevant evidence of that in Mr Powell's witness statement, back at bundle B, tab 4, and we can pick it up at page 115.

At the bottom of page 115, your Lordship sees there's a heading, (iii), "The Amended Model 2 Terms". If you turn over the page, you can see by the second hole punch, there's a paragraph starting:

"75.3. Clause 24.1 ..."

Could I just invite you to read that section. So starting on B115 and finishing at B116 before you get to paragraph 75.3.

HIS HONOUR JUDGE RAWLINGS: Yes.

MR GLEDHILL: So the hearing bundle, for obvious reasons, break under its own weight, doesn't purport to account for each and every communication Lendy sent to its investors. But Mr Powell's evidence is that it was his impression, in the last sentence of 75.2, that Model 2 Investors would recover their capital before Lendy would recover any amounts due to it, and he wasn't cross-examined about that. And that is, at the very least, consistent with the e-mail I showed your Lordship a moment ago, dating from February 2018.

If you keep Mr Powell's statement open and we dip

back into the second of the E bundles, E2, tab 110. If your Lordship has that, it's a document headed "Investor Round-up". It's an exhibit to paragraph 76 of Mr Powell and he tells us it dates from 16 March 2018. And the key bit is a few pages on at E484 —— 483, in fact, you can start. You'll see right at the bottom of 483, there's a heading, "New Rules". So this is the e-mail that announces the change to the Model 2 rules. And you can see what it says on page 484. It starts at the top:

"Below is a quick summary of what's new.

"The refreshed [terms and conditions] ... published on March 5th 2018 reflect recent changes we have been making ..."

Next paragraph:

"It also included reference to the addition of a voting feature ..."

That's the provision I showed your Lordship yesterday, clause 16. Then it says this:

"The other main addition is a clarification and strengthening of Clause 13.3 which relates to investor protection in the event of a distressed sale of an investment asset.

"It is important that you familiarise yourself with the new set of [terms and conditions] ... in their entirety."

Next paragraph:

"If for any reason you 'dont agree to our new terms and would rather close your account than opt out of specific new features, you can do so by selling your loan parts and contacting Support who will advise on closing your account."

Two points to make about that. The first, the suggestion by Lendy that the new clause 13.3 represents a "strengthening of investor protection" is bluntly devious. What Lendy has in fact just done is to introduce a provision which tells investors that Lendy's own dues are not only in competition with the investors but will in fact rank ahead of amounts owed to investors.

Secondly, if my Lord looks back to what Mr Powell says about this, there is some useful evidence back in the B bundle, tab 4, page 116.

You see at the foot of page B116, if you have that, that he is dealing at paragraph 76 with the document that you've got open.

If you turn over to B117, you can see that he makes some comments about that suggestion, that if investors don't like it, they can get out. Can I leave you to read paragraph 76.2 to yourself.

HIS HONOUR JUDGE RAWLINGS: Okay.

MR GLEDHILL: So far as the evidence goes, clause 13.3 of the amended Model 2 Terms is the first occasion on which Lendy flags to Model 2 Investors that their interests and its own interests may be in conflict in a recovery situation. It does that by sending them a copy of the Model 2 Terms under cover of an e-mail that gives a thoroughly misleading account of the effect of that change, and it tells them that if they don't like it, they can opt out, at a point by which that was practically very difficult to do.

Two things happened after the publication of the Model 2 Terms.

First, was an intervention by the Financial Conduct Authority which we referred to at paragraph 52 of our skeleton argument.

I want to take you through that now in a little more detail by reference to the contemporaneous documents. Just to set the scene from this, your Lordship knows, I've already told you this, that interim authorisation for Lendy was given by the FCA in February 2014. And we know that it applied for full authorisation on 30 March 2016. And for your Lordship's note, the dates are in Webb 2, paragraphs 16 and 48.

HIS HONOUR JUDGE RAWLINGS: When did you say it applied for full registration?

MR GLEDHILL: They got interim authorisation February 2014 and they applied for full authorisation on 30 March 2016.

HIS HONOUR JUDGE RAWLINGS: Is it easy to say what the difference between interim and full is and why you'd want full?

MR GLEDHILL: Not -- it's not something that we've specifically applied our minds to. There are differences, but I'm afraid I haven't specifically checked back with the statutory framework and we'd need to do that to give a proper answer.

HIS HONOUR JUDGE RAWLINGS: It's fair to assume there is some benefit in obtaining full registration.

MR GLEDHILL: Absolutely. Your Lordship is already alive to the point that the process for Lendy of obtaining full authorisation was a pretty extended process, and as at the date Lendy published its amended Model 2 Terms in March 2018, so close on two years after the date it applied for full authorisation in March 2016, Lendy still did not have full FCA authorisation. And Webb 2, paragraph 61 tells us that it did eventually get it on 11 July 2018. So it took about two and a half years.

Why the delay? Well, the document suggests that the delay was referable to the FCA having considerable reservations during the course of that two-and-a-half

year period about various aspects of Lendy's business. We don't have time to get into that topic at any level of detail, but I do just want to show you a couple of the relevant letters to give you the flavour. Both of them are back in file E1, so you can put away E2 for the moment.

In bundle E1 the first one is a letter you'll find at tab 44. It dates from 12 August 2016, so this is roughly six months after Lendy has applied for full authorisation. And you can see -- I'm not going to read this extensively at all, but I'll just dip into a few passages to give you the flavour, on the first page:

"What are we writing to you about?

"We have concerns about the following advertisements (which are subject to our rules on communicating with clients, including financial promotions) ..."

Then it references various things on the website. Then there is a subheading by the second hole punch:

"Why are we writing to you?

"We have some concerns that these advertisements do not comply with our rules and guidance in the Conduct of Business Sourcebook ... We consider that your advertisements may not meet our requirements to be fair, clear and not misleading ..."

If you look at the penultimate line of the page, you

can see the reference to COBS 4.2.1 which was the provision I mentioned to your Lordship yesterday in the context of this debate.

Just over the page, perhaps one point to draw out from this at E161, one of the things that is particularly concerning the Authority is that at that point Lendy is trading and calling itself Saving Stream which the Authority believes runs the risk that investors will believe that peer-to-peer lending products are something analogous to a bank account. And you see in the middle of the page, paragraph 4:

"We consider that the use of the trading name 'saving stream' is misleading for the reasons set out above."

That dates from about six months after the application for full authorisation.

If you now turn on to tab 79, we now have a letter from the Authority dated 1 June 2017, so we have moved on about ten months in time from the letter you have just seen. And as your Lordship will see from this, the FCA is still considering Lendy's authorisation application and sets out a large number of reservations including, again, about whether Lendy's promotional materials are misleading.

It's a long letter, I'm not going to go to it in any

detail at all, but you can see that if you dip into page E267, and just glance at the bottom paragraph under the heading, "The Lendy website and financial promotions":

"The FCA has considered the new Lendy website and in our view, it lacks balance."

And it goes on.

So this letter, the letter we're looking at now, pre-dates the amendment of Lendy's lender terms and conditions in March 2018 by approximately six months. And by the time Lendy put out those terms and conditions, it had been having a difficult time with the regulator for an extended period in its bid to gain full authorisation. And that is the context of a very important exchange between Lendy and the regulator, for which we have to go back to bundle E2. We pick it up in there tab 108 to begin with. You can see in the middle of the page, it's an e-mail from Robert Cooper at the FCA to Paul Coles. Paul Coles is head of regulatory compliance at Lendy, dated 6 March 2018, and so this is very close in point of time to the publication of the amended Model 2 Terms. I'll just read some extracts from it:

"Dear Mr Coles

"I refer to previous correspondence regarding Lendy Ltd's Part 4A application. To confirm, Authorisations

are still in the process of preparing our formal 'Minded To Refuse' letter and this will be issued in due course."

And that's important. So at this point, getting on for two years into the process of considering the application for authorisation, the Authority is indicating to Lendy that as things stand, it is minded to refuse that application. And the letter goes on, the e-mail goes on:

"However, it has come to light that Lendy has amended the published lender's Terms and Conditions on its website on 5 March 2018. On initial consideration of these, it appears that these are an amended version of the terms and conditions submitted to the FCA and dated 23 June 2017 ..."

And then skip down to the last two lines of the page:

"Based on our initial review of latest terms and conditions, we note two substantive changes compared to the previously published version ..."

Over the page you can see what those are. The first one is section 16 about opinion of lenders. That's the provision I showed you yesterday. But what really matters is the next point, starting:

"The firm has introduced substantial changes ..."

"The firm has introduced substantial changes to clause 13 ..."

And it then quotes the provision. And then it says:

"Please respond to the following questions by [close of business] 8 March ..."

I'm going to read you 2 and 6:

"2. How has the firm communicated the change in terms and conditions to its lenders prior to the publication on 5 March ... Please provide screenshots or correspondence to support this ...

"6. Please explain whether the 'order of preference' referred to in clause 13.3 existed prior to 5 March 2018. If so, where this was previously documented within Lendy's loan documentations, terms or internal policies, and how was this clearly communicated to investors?"

And then your Lordship sees the follow up exchanges to that if we now go on to the next tab, tab 109 and we need to read it backwards. They are in reverse order. So we start at page E481, please. E-mail from Mr Cooper -- sorry, an e-mail from Mr Coles to Mr Cooper, dated, if you look back at the bottom of the previous page, it's from 9 March, and back on E481:

"Good morning Robert."

We will skip the first paragraph. In relation to

the second paragraph, he says this:

"The changes to the payment waterfall ('order of preference' clause (13.3)) were non-material clarifications to ensure that investors' interests are completely clear and transparent in the event of a formal or distressed asset disposal, against which a first or second charge is held. Our legal team have confirmed that these minor changes cause no practical or legal detriment to investment, indeed the complete opposite."

Indeed the complete opposite. Then turn back to page 479. FCA's response. This is Mr Cooper on 13 March 2018. Reading it from the paragraph in the middle of the page, he says this:

"Our concern here is that, until 5 March 2018, it appears lenders were not previously provided with an explanation as to the 'order of preference' and to all intents, this is new information. We also note Lendy also does not provide any information about its 'unpaid fees, costs and expenses' that would enable lenders to establish the likely cost when an asset sale leads to a shortfall.

"If this 'order of preference' was always in place, 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 an lender formulate a view as to the likely risks of losing their investment (COBS 14.3.2R(1))."

And then there is the crucial reply to that, which your Lordship finds if you now turn back to E475, and the reply is the document that starts at the second hole punch. Just so your Lordship understands, what's happened is that Mr Coles has e-mailed back to Mr Cooper his original e-mail with mark-up, and one suspects that in the original, it may have shown in colour but it doesn't on this, but I can tell your Lordship what is Mr Cooper's e-mail and what is Mr Coles' e-mail.

So if you look at the last paragraph on this page, you can see "our concern here is that". That's what I have just read to you from Mr Cooper. And turning over the page, the quote from Mr Cooper stops at the second line with the words "order of preference". And then what you see there, running between the words "all capital payments" in the chunk that runs out slightly skewed out to the left, all of that is Mr Coles' reply, Lendy's reply. So it finishes just before the paragraph you get to in the middle of page starting with the words "if this 'order of preference'".

Could I just invite you to read that extract through to yourself, just to save my reading voice, and then

I'll make some points about it.

HIS HONOUR JUDGE RAWLINGS: Yes.

MR GLEDHILL: You see it then goes on, after the extract you have just finished, to quote again Mr Cooper's e-mail back to him:

"If this 'order of preference' was always in place, we consider this to be material information ..."

If you just cast your eye about eight lines down in that paragraph, you should see a sentence starting:

"As per my previous e-mail ..."

Now, that is Mr Coles replying to that point. So the FCA has asked, "Was this ever flagged to the investors before?"

And Mr Coles says:

"As per my previous e-mail we freely acknowledge that prior notification wasn't provided on this occasion."

So there are three points to make about this reply by Mr Coles to the Authority. The first is that the sentence I have just read out accepts that investors were not told about the priority of waterfall in clause 13.3 before the Model 2 Terms were amended and sent out. By which time, as I have already explained to your Lordship, by reference to Mr Powell's evidence, they were effectively locked in.

The second point. The higher of the two extracts from Mr Coles' e-mail that I have just read to your Lordship, or asked your Lordship to read, is the clearest possible representation to the Regulator that in any shortfall case, Lendy would prioritise the monies owed to investors above the monies owed to Lendy itself. Your Lordship sees what Mr Coles says. He describes it as a "key foundation stone of the business".

The third point. We know that Lendy finally got its FCA authorisation four months after the date of this exchange. There is nothing anywhere in the bundles to suggest that at any point in that four-month period, Mr Coles or anyone else at Lendy told the Financial Conduct Authority that Lendy had had a change of heart on what the FCA plainly regarded as a fundamental point.

HIS HONOUR JUDGE RAWLINGS: I suppose a rhetorical question, which is if this assurance was given to the FCA as to how Lendy intended to do things in practice, why didn't the FCA come back and say: well, that's good then, you'll be changing clause 13.3 because it says the opposite.

MR GLEDHILL: Well, the evidence doesn't give you a clear answer to that. Because the paper trail in relation to this is very incomplete. But we know what Lendy did to give effect to this undertaking, and that is the point

that I'm coming on to immediately next. Lendy did do something to honour the undertaking that Mr Coles gave to the FCA.

The point that I was making to your Lordship, that in circumstances where the FCA plainly regarded this as a highly material point, and gave full authorisation four months later, your Lordship has to assume that the assurances given in this e-mail were fundamental to the Authority's decision to grant that authorisation to Lendy, and indeed perhaps to permit Lendy to continue in business at all.

HIS HONOUR JUDGE RAWLINGS: Now, we are running up to 12.26. So that will be around almost an hour and a half we have been going in this morning's session. What is going to be a good point for a break.?

MR GLEDHILL: Well, I was -- so your Lordship knows, I probably have about another 30 to 45 minutes and we started a little bit late and I was very grateful to your Lordship for that. It gave me a slightly more civilised start time this morning than I might otherwise have had. It is very much up to your Lordship; we could either take a short break now for the transcriber or we could rise for a short adjournment as an early lunch break and then come back and knock this point off when we come back. It's entirely a matter for you.

HIS HONOUR JUDGE RAWLINGS: To get to the end of what you want to say, it's about half an hour, is it?
MR GLEDHILL: Yes. I think I might get to the end of it before 1 o'clock. It might be a little after 1 o'clock.
HIS HONOUR JUDGE RAWLINGS: Let's take a break until 12.35, and then if you —— we run over as necessary to accommodate your submissions. I know that Ms Toube will want to come back again. If Ms Toube thinks she's going to be 10 or 15 minutes, depending on how I'm feeling about it, maybe 20 minutes, then it may be that we will do it and finish off at that stage. Otherwise we'll adjourn until after lunch. So we'll see where we get to, and Ms Toube can let me know how long she is likely to be. We may get it all wrapped up before taking a late lunch, or we will come back after lunch. But anyway, if we come back at 12.35, 25 to 1, please. Thank you.
(12.28 pm)
(A short break)
(12.35 pm)
MR GLEDHILL: Before the break I showed your Lordship the e—mail exchange between Lendy and the Authority. Before I show you my next document, I just wanted to remind you of something in the administrator's skeleton argument that relates to this. It is at page 51 of their

skeleton.
And they set out —— in the middle of that page, they set out a chunk from that e—mail. At 155, they say this e—mail is not an aid to construction. Of course we are not suggesting anything of the sort. I will come back to what we are saying about this in a moment.
Then at 156.1, they say this:
"There is no suggestion that the email from Mr Coles was disseminated to Model 2 Investors."
Formally, of course, that is correct, but in a pretty empty formal sense, because substantively it is very wrong indeed by reference to the document that your Lordship sees, if you turn on within bundle E2 now, to the document you find at tab 112.
E, 112 is a document exhibited to Mr Powell's paragraph 77. He tells us this dates from 13 April 2018, so this is pretty much exactly a month after the exchanges with the Financial Conduct Authority that you have been looking at. And your Lordship asked a moment ago, what did Lendy do to give effect to the assurances Mr Coles gave to the Authority. The answer is this. Turning on to the second page, E493, "Collections and recoveries", middle of the page, "the new policy".
HIS HONOUR JUDGE RAWLINGS: I should have written it down,

you gave me a date when this was sent according to Mr Powell.
MR GLEDHILL: The date was 13 April 2018.
HIS HONOUR JUDGE RAWLINGS: Thank you. Yes.
MR GLEDHILL: Paragraph 77 of his witness statement. Middle of page 493, by the first hole punch, "Collections and recoveries —— the new policy":
"This new policy outlines to borrowers what we expect of them and aims to give our investors comfort about the robust procedures Lendy has in place to protect them in the case of the borrower's default."
Skip the next paragraph.
"The policy outlines ... "
Fourth bullet point:
"Priority of payments to investors.
"You can read the new Collections and Recoveries policy here."
And the link document you get to is the one you see if you turn back to tab 111. It started off on page 487. Let's start it off on page 486, because this is a document that the administrators have found, and so you can see if you look at the subject, "[Collection and recovery] policy —— new", so this is a new policy, dating from 27 March, so very roughly a fortnight after the exchange of e—mails with the conduct authority that

I've just shown you, and then announced to the investors about three weeks later.
The first page is E487, "Collections & Recoveries policy":
"The purpose of this policy is to set out the action Lendy takes to encourage borrowers to repay ... also serves to set out the action Lendy takes when a borrower [is] unable to repay ... "
And the critical passage of course is the one that Ms Toube has already shown you at E489. On the right—hand column, "Priority of payments":
"Unless Lendy is receiving a payment from a borrower in connection with an extension, the funds forwarded ... shall be put to the amounts owing with the following priority:
"1. Capital ...
"2. Interest ...
"3. Bonus accrual
"Lendy will only take any portion of interest or fees owing to them once all of the above have been satisfied."
Now, the terms of the first recovery policy, so just pausing there. The answer to your Lordship's question: what did Lendy do pursuant to that exchange with the Financial Conduct Authority to assure it that its —— the

Authority's concerns had been addressed?

The straight answer is the bundles do not conclusively tell us; but the overwhelming inference from the timing of this document is that this was Lendy's response to the problem identified by the Authority. It is what set the Authority's mind at rest. But its terms were, of course, inconsistent with clause 13.3 of the amended Model 2 Terms. And your Lordship has seen that Mr Powell picked up on that. And I'm just going to take you back quickly again through the relevant exchange, just making one or two comments in addition to the comments that my learned friend made.

The first document is at 114, E499, so just so your Lordship has it clear in your mind, 13 April is the date that the first collection and recoveries policy is sent out to the investors. And this is a message from Mr Powell of 30 April. So 17 days later he has picked up on the discrepancy, and he says:

"Could you explain the discrepancy between clause 13.3 in the [terms and conditions] ... "

And the recoveries policy. And he sets it out. And then you go on in tab 114, in the same tab to page 500. And your Lordship has already seen this with Ms Toube. A reply —— interestingly, it takes them a little bit over a week to answer that simple question, and they say

there by the second hole punch:

"The order of payments in the event of a shortfall will be as per the Collections & Recoveries policy.

"We will be updating the [terms and conditions] ... so that they correspond with the Collections & Recoveries policy."

And then page 504, Ms Toube showed you this e—mail, an e—mail now from 1 August. So just to be clear, it's now been three months. So Lendy has committed to Mr Powell that the amended terms will be re—amended to bring them into line with the collection and recovery policy, and here is Mr Powell three months later saying: what's happening? And nothing has happened in that time with, of course, one important exception. In that three—month period, on 11 July 2018, Lendy has now got its FCA authorisation.

And following that, two things now happen. The first is Lendy simply ignores further e—mails from Mr Powell on this subject. Again, I'll take you through them quickly through again. They're at tab 121. The first one is at E528 on 13 September. So this is five months after they have committed to amending the terms to bring them into line with the recovery policy. And then the other one that you see at E530, again, by the second hole punch, Mr Powell now on 3 October:

"Seriously? A cut and paste of the previous answer from 5 months ago."

And then above that the support team by the first hole punch:

"I have referred your enquiry to the legal team and I will get back to you as soon as I have an update ..."

Nothing thereafter. It's pretty remarkable, we suggest, that Lendy should have simply fobbed off Mr Powell in this way, given the categoric assurance they gave to him in May 2018 and the categoric assurance that they gave to the FCA in March 2018. But what is simply astonishing is what they then did next. And that is in the third of the E bundles, E3, tab 194. And that of course is the second recovery policy. And your Lordship has seen the material passage; it's at bundle page E966.

HIS HONOUR JUDGE RAWLINGS: Remind me when this is issued.

MR GLEDHILL: I'm going to give you the answer to that in just a moment. E966 first of all. That's the relevant bit. "Priority of payments". What was there before deleted and amended to read:

"Payments ... from a borrower or as a result of any enforcement action will be applied as set out in Lendy's Lender terms and conditions."

Flat contradiction of the assurance begin to

Mr Powell. Completely inconsistent with the assurances given to the Financial Conduct Authority in March. The answer to the question: when does this document date from? I can show your Lordship. I have mentioned this a couple of times in the course of submissions already but your Lordship should just see it. It's in the A bundle. Tab 4 in that is the statement of agreed facts. And within that, so file A, tab 4, if you turn up page 45. Sorry, I am still getting there myself. You see a paragraph midway between the two hole punches:

"Despite the statement the Lendy Legal Team made ..."

If you read that and the continuation paragraph (b) over the page.

HIS HONOUR JUDGE RAWLINGS: Yes.

MR GLEDHILL: So we don't know the date, but on 28 August 2018, Lendy is still telling Ms Taylor that loans in recovery are going to result in a recovery of capital first. And your Lordship will note that in the e—mail exchanges between Mr Powell and Lendy that I have just showed you, there is no whisper in that of a suggestion that, in fact, the first recovery policy has been withdrawn, those e—mails at the end date from September and October.

So it looks as if this second recovery policy comes

very late in the chronology.
HIS HONOUR JUDGE RAWLINGS: Are you taking the fact that they told Ms Taylor on 28 August 2018 as some indication that it was after that date?
MR GLEDHILL: Yes, because they tell her, looking at the top of page A46:
"This loan is currently in recovery and therefore our collections and recovery team will recover capital firstly."
Which would be inconsistent with the terms of the second recovery policy.
HIS HONOUR JUDGE RAWLINGS: It would, but I don't think any of us can be confident that ——
MR GLEDHILL: That is fair comment, but what is extremely surprising is that if the second recovery policy predated the exchanges between Mr Powell and Lendy that your Lordship has just seen from September and October 2018, they would not have mentioned the existence of that policy in those exchanges.
So, I have three short points to make about the second recovery policy and its significance. The first is there is no evidence anywhere to suggest Lendy told the Financial Conduct Authority that it was now proposing to do something completely contrary to the assurances that it gave in March 2018 that it was

prioritising lenders in a shortfall case.
The second point to make is that whereas, as your Lordship has seen, the first recovery policy was announced to lenders with a fanfare in an e—mail in April 2018 in the e—mail I showed you, the second recovery policy was smuggled in through the back door without telling anybody about it, and if your Lordship will get that out, I can take you to it if you like, but it's paragraph 79.6 in Mr Powell's witness statement, at B, tab 4, page 119, where he says investors were never told about it.
HIS HONOUR JUDGE RAWLINGS: Do we know it was on the site at all?
MR GLEDHILL: Well, there's an interesting side issue about that, because Mr Powell makes the point that if you go to the 13 April announcement, as it was up on the website, at some point somebody has changed the link so that it takes you —— instead of taking you to the first recovery policy, it takes you to the second recovery policy. So the straight answer to your question is that at some point somebody changed the link in the 13 April investor announcement, so that anyone who clicked on it was taken to the second recovery policy.
We don't know who did that and we don't know when they did it and we don't know why they might have done

that. Rather than simply more candidly putting out another announcement saying there is a new policy.
The third point I just wanted to make by reference to the second recovery policy is this. It looks strongly on the evidence that it post—dates September/October 2018. Your Lordship knows, I've made this point a number of times, Webb 2, paragraph 80 tells us that Lendy wrote its last loan on 18 September 2018. So it looks as if the second recovery policy post—dates the point at which Lendy ceased bringing new lenders in.
That concludes what I was going to say to your Lordship about the fact. And I'm now going to outline quickly what I say are the applicable legal principles before making some succinct submissions about what it is we say your Lordship should decide under this limb of the application.
HIS HONOUR JUDGE RAWLINGS: Yes.
MR GLEDHILL: If I can take you back to our skeleton argument. Paragraph 47 on page 40, please. My Lord has read this. We crystallised from the text that when a trustee is faced with a discretionary exercise of power, and is uncertain about whether or not to exercise it in a particular way, they can generally do one of two things. They can either take the decision and go to the

court and seek the court's approval. That's the possibility we refer to in 47.1. And if that is what is done, then the court's function is a limited one. It's effectively limited to reviewing whether or not the primary decision—maker, the trustee, has exercised its discretion in a way that is within the limits of rationality and honesty.
Alternatively, a trustee can seek to surrender its discretion to the court and say to the court, take the decision for me. And where that is what happens, as you can see in the extract from Lewin we set out in the middle of paragraph 47.2, the court will act as a reasonable trustee could be expected to act having regard to all the material circumstances.
So in that situation, it is exercising an original discretion and on a review jurisdiction.
And we make the important point at paragraph 47.3 that the trustee typically surrenders the discretion to the court, where the trustee is a company in liquidation, and the trustee may itself be one of the objects in respect of which the power is exercisable. And the reason for that is discussed in a case called Thrells. I'm not going to show your Lordship that in any great level of detail, but I do just want to remind your Lordship of the key passage in it. It's in your

authorities bundle, tab 12. Thrells v Lomas, a decision of Sir Donald Nicholls that dates from 1992. We don't need to trouble too much with the facts.

If you turn on to page 286, the simple point here is that there is a pension scheme that is in surplus and the trustees have a discretion what to do with it. They can kick the surplus back to the company that is now insolvent. The company is itself the trustee. Or they can apply it among the other objects of the pension fund.

Just looking at D, you'll see that the liquidator was represented by Nicholas Warren as he then was, later Mr Justice Warren and the material passages run between letters F and H. Can I ask you to read those two paragraphs to yourselves:

"Before me is an application ..."

And the next one:

"In these circumstances ..."

HIS HONOUR JUDGE RAWLINGS: Okay, yes.

MR GLEDHILL: The simple point to collect from that, at 459, H, is Sir Donald's comment that the liquidator is confronted with an impossible conflict of duties. And your Lordship will bear in mind that where the insolvent company, of which the liquidator is the office holder is one of the objects potentially of a discretionary power,

there are, at the very least, two compelling reasons why the position is one of impossible conflict. The first is that the liquidator in his capacity as such owes duties to unsecured creditors which conflicts with his duty to have regard to the interests of the other beneficiaries of the trust. Wearing his liquidator hat, he has to favour the unsecureds. Wearing his trustee hat, he cannot possibly lean towards the unsecureds because that is not the power conferred upon him by the trust.

And the second and not immaterial consideration is that the office holder will also have a claim against the insolvent estate for his own fees.

And your Lordship will remember earlier this week that my learned friend's instructing solicitors circulated an estimated outcome statement giving you a few figures. And that statement, we may go back to it in a moment, showed that the administration costs, including remuneration and expenses to date, total a little over £6.5 million for two years.

So there is no possible basis upon which the administrators in this case, in their capacity as SSSHL administrators, being also the administrators of Lendy, could possibly take a decision about who the proper distributed beneficiaries under the power constituted by

the debenture should be.

HIS HONOUR JUDGE RAWLINGS: I suspect you're going to come to it. Ms Toube puts it slightly differently in that she suggests that, okay, we have a conflict but what we're asking you to do is to direct us what to do rather than surrendering our discretion to the court.

MR GLEDHILL: Well, I'd say it's a distinction without a difference. You can go to the court and say: tell us what to do; tell us what to do in our capacity as administrators and we will cause the trustee to do that. That is effectively one and the same as saying we are surrendering our discretion to the court.

It may be a distinction without a difference, but what absolutely cannot happen is that the administrators cannot say to your Lordship: determine the relevant principles, decide whether the Model 2 lenders are correct in the analysis that they are suggesting of how the discretion should be exercised, and then we will treat that merely as an illuminating explanation of the principles and go away and exercise our discretion.

MS TOUBE: My Lord, just in case it helps cut through this point, we absolutely aren't saying that. We are asking your Lordship to give us a direction as to how to exercise our discretion and we will do it.

HIS HONOUR JUDGE RAWLINGS: In that respect, the principles

that I should apply are no different than if the discretion was surrendered to the court. Okay.

MR GLEDHILL: We are happy then. We are both on the same page. As I say, if there is a distinction at all, it's a distinction without a difference. I think we are both saying to your Lordship that effectively you put yourself in the position as the trustee, and where one characterises it as the court taking a decision as a trustee or the court telling the administrator what to do is a distinction without any practical significance, so we can move on from that.

So I have already shown your Lordship what the approach is by reference to paragraph 47.2 in our skeleton. You don't need to go back to it, but just quoting it back to you:

"... [the court] ... will act as a reasonable trustee could be expected to act having regard to all the material circumstances ..."

I'm now coming on to a slightly different point. I notice the time. Entirely up to your Lordship. If you want me to keep going, I can keep going, or if you want me to break, I can break.

HIS HONOUR JUDGE RAWLINGS: How much longer are you likely to be?

MR GLEDHILL: In total, so I am going to be about 25,

20 minutes or so.
HIS HONOUR JUDGE RAWLINGS: Ms Toube still has to come back to provide her reply, so we are going to have to come back this afternoon anyway. If that's a convenient point, we may as well break at that point. I am assuming that the two hours that we have after lunch are more than adequate to deal with anything you want to say and Ms Toube wants to say. Let's come back at 2 o'clock, please.
(1.00 pm)
(The short adjournment)
(2.00 pm)
HIS HONOUR JUDGE RAWLINGS: Good afternoon. Sound good?
MR GLEDHILL: Sound is very good.
HIS HONOUR JUDGE RAWLINGS: Mr Gledhill, carry on.
MR GLEDHILL: I had finished dealing with the facts. We'd established the parameters of the exercise which your Lordship is being asked to conduct, and then the starting point for discussion when it comes on to the question of what should the court do and what are the principles is just to take you back quickly, if I may, to the relevant provision in the debenture, C10, page 182.
21.1 says that the monies received by the security agent will be applied in the following order of

priority:
"21.1.2 in or towards payment of or provision for the Secured Liabilities in any order and manner that the Security Agent determines ..."
So the first point to make is, the trustee under that has an unqualified discretion. And it's important just to notice the words "in any order", so the proposition that we are advancing to your Lordship is not that Lendy be disentitled from participating. Couldn't do that. The trust says otherwise. But what we are saying is that the claims of the Model 2 Investors would be discharged in full before a penny goes to Lendy under clause 21.1.2.
And it's important to make a point to your Lordship, which is possibly obvious, but can do with spelling out in any event. Each of these trusts is a separate trust in respect of separate loans and separate security. So if there is only quite a moderate shortfall to the class of Model 2 Investors in respect of any given loan, and that obviously may depend significantly on the answers that your Lordship gets to under issues 5 and 8, then on the distribution model that we're proposing, what happens is that the Model 2 Investors come out first and then Lendy gets the rest.
We are not saying that there should only be any

distribution to Lendy at all once all of the claims of Model 2 Investors are fulfilled. We couldn't say that because each of those debentures constitutes a separate trust. Quite an important point. Maybe obvious, as I say, but it's worth making.
So far as that is concerned, what are the principles? The administrator's skeleton argument has taken your Lordship to the very well-known House of Lords' decision in Braganza and Lady Hale's well-known remarks in that about the duty of good faith in contract. And that has nothing to do with the issue before your Lordship.
Braganza is concerned with a situation where there is a contract, bipartite or multipartite, where one of the parties has a discretion conferred upon them, which can adversely impact the rights of the other party and impact its own rights. And what Braganza tells you is that the courts are more ready now than they used to be to imply terms to the effect that that discretion has to be exercised rationally and reasonably, has to be exercised in a particular way, and has to come to a conclusion which is within certain parameters.
And that case isn't of any assistance to your Lordship because what your Lordship is concerned with is an express trust. And the person exercising the

discretion here is the trustee who, of its very nature, cannot have any beneficial interest in the subject matter, and the obligations which that trustee owes are obligations in equity and not of law.
And in fact Braganza doesn't help your Lordship because the points that are made in Braganza are all parts of the trustee's duty in any event.
Now, it is a question that frequently arises in a trust context where a trustee is given a discretionary power to disburse a fund amongst a defined class of beneficiaries. As to the circumstances in which and the principles by reference to which the trustee can say: well, the objects are A, B, C, D and E, those are the people among whom I can distribute it, can I give it all to A, can I give it to A and B or do I have to give it to A, B, C, D and E equally, or how does it work, what are the principles?
And the answer to that question is adequately addressed in three materials which we have put into your Lordship's bundle. The first is a short extract from Lewin, and my Lord finds that at tab 63 in the authorities' bundle.
HIS HONOUR JUDGE RAWLINGS: Yes.
MR GLEDHILL: And the relevant extract is at page F1598. At the top of the page, paragraph 29-062, "Duty of trustees

... to act impartially":

"Trustees must act impartially, that is, they must hold an even hand among all the beneficiaries, except insofar as the settlement authorises them to discriminate."

And then you see the important commentary at 29-064 between the two hole punches. Can I ask you to read that to yourself, please.

HIS HONOUR JUDGE RAWLINGS: Yes.

MR GLEDHILL: The point being made there is where you have a power whereby you say to a trustee, "Here is £100, you make a decision about how you want to distribute it as between A, B, C, D and E", it is inherent in the nature of that power that the trustee can decide to give £20 to each of them, £100 to one of them, £25 to four of them and nothing to one of them.

It's meaningless in that situation to say that the only rational way in which it can be exercised is by pari passu distribution. The essence of the power is that the power is given to the trustee to make a decision, and that that decision may connote ultimately an unequal outcome. In fact a pari passu distribution, unless there is good reason for it, may of itself be an abdication of that power.

And that is the point which you see Lewin making in

the second and third lines where he says:

"The very discretion conferred is to prefer one over another; unfairness is not a ground of challenge."

And the authority for that and the second of the materials I wanted to take you to, which underpins that, is a decision of the Court of Appeal in a case called Edge v Pensions Ombudsman, tab 15 of the authorities bundle.

We summarise the factual background to this in our skeleton argument, so I'm not going to take you to the headnote. But in a nutshell, a situation had arisen under a pension scheme which enabled the trustees to confer additional advantages, and they had exercised that power to confer additional advantages on one class at the expense of another class. And the pension ombudsman received a complaint from a disappointed beneficiary, and he upheld that complaint on the basis that he said the trustees had a power to act in an even-handed way between the beneficiaries.

And there was an appeal to the first instance judge, Sir Richard Scott, which was successful. There was then a further appeal to the Court of Appeal, and the Court of Appeal upheld Sir Richard Scott. And I wanted to show you two things in this decision. The first is on page 626. Leading judgment is Lord Justice Chadwick

and we're in his judgment. On 626 you see just beneath the letter F, he starts talking about the need to consider the circumstances in which the surplus has arisen.

And the point I just wanted to bring out is, he sets out there a variety of the considerations which the trustees could reasonably have had regard to, but the key one to get out of it is the one you see between letters G and H, just off the bottom of the page:

"They must, for example, always have in mind the main purpose of the scheme ..."

So that is the benchmark.

And then what he goes on to say over the page is that once the trustees have had regard to the main purpose of the scheme, if they in their discretion arrive at a very unequal result, provided they haven't misconducted themselves on ordinary equitable principles, that decision stands.

And you will see between letters D and E, a paragraph starting in the middle of the page between the hole punches, where he addresses the submission advanced by the Pensions Ombudsman which was the basis for the decision, which was then the subject of the litigation, where he says this:

"Properly understood, the so-called duty to act

impartially -- on which the ombudsman placed such reliance -- is no more than the ordinary duty which the law imposes on a person who is entrusted with the exercise of a discretionary power: that he exercises the power for the purpose for which it is given, giving proper consideration to the matters which are relevant and excluding from consideration matters which are irrelevant. If pension fund trustees do that, they cannot be criticised if they reach a decision which appears to prefer the claims of one interest -- whether that of employers, current employees or pensioners -- over others. The preference will be the result of a proper exercise of the discretionary power."

And then if your Lordship turns back in the same volume in the authorities to tab 6, we provided you there with one of the war horses of equity jurisprudence, McPhail v Dalton, which was a decision about a fiduciary power to distribute a fund amongst a very large class of objects. And one of the points taken there was that it gave rise to difficulty because the class was defined in such a way that it was difficult to understand all of the individuals who might be within it, and a suggestion was made: well, how do the trustees exercise that power? Because isn't their prima facie duty to follow the maxim, equality is

equity, and distribute pari passu.

If you turn on to page F176, you see what Lord Wilberforce said about that. Just after letter A, four lines down:

"As a matter of reason, to hold that a principle of equal division applies to trusts such as the present is certainly paradoxical. Equal division is surely the last thing the settlor ever intended: equal division among all may, probably would, produce a result beneficial to none. Why suppose that the court would lend itself to a whimsical execution? And as regards authority, I do not find that the nature of the trust, and of the court's powers over trusts, calls for any such rigid rule. 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."

So what this is telling your Lordship is in the situation —— Edge was concerned with the situation where the trustee had taken the decision and had preferred certain beneficiaries over others, and that was subject to challenge. In this case the court is concerned with asking the question: how would it execute the power if

it stood in the place of the trustee, if the trustee had surrendered its discretion.

And what Lord Wilberforce is saying here is well, you find cases of family trusts generally dating from the 19th century where the court isn't in any position to second-guess the settlor and to prefer one member over the other, and so errs towards the principle that equality is equity, but that is effectively purely a default rule.

And we made the point to your Lordship in our skeleton argument the trustee here was constituted as SSSHL. There are some cases where the court is in difficulty in deciding what might be a fair method of distribution because it's simply not as close to the coalface of the facts as the trustee was, but we respectfully suggest to your Lordship that having read the evidence you have read and listened to four days of legal argument, you are as well placed as anyone, with respect, is ever likely to be.

So those were the three materials that we say condition the approach that you should take to the exercise of the discretion, or in giving the administrators, as they would have it, directions as to how they should exercise their discretion.

And we suggest that it is clear that you or they

have a free hand to apply the trusts —— unequally the funds, unequally as between Lendy and the Model 2 Lenders. And as your Lordship knows, we say you should exercise that discretion to exclude Lendy from participation, unless and until in respect of any given loan, the shortfall to the Model 2 Investors has been made good.

Now my learned friend places emphasis on the fact that Lendy is now insolvent. And I make the point to your Lordship that the beneficiaries of the trust are not the unsecured creditors of Lendy. But it's nevertheless worth just reminding ourselves who those unsecured creditors are.

Does your Lordship have to hand the estimated outcome statement which Shoosmiths circulated, I think on Monday evening?

HIS HONOUR JUDGE RAWLINGS: Probably not to hand, but I can go back and get it. You think it was Monday evening.

MR GLEDHILL: I think it was Monday evening. Someone can correct me if I'm wrong about that. It was an e-mail from Ms Doyle, and ... I have it. Would it be —— it was an e-mail of ——

HIS HONOUR JUDGE RAWLINGS: Estimated outcomes statement as at 23 May 2021, that?

MR GLEDHILL: Yes, that's the one. So who are the

creditors? Taking them in order of size, the largest class —— leaving aside the Model 2 Investors, the largest class is the Model 1 Investors at 12.5 million, but that obviously depends on the answer that your Lordship gets to under issue 3.

HIS HONOUR JUDGE RAWLINGS: So in the event that they are on limited recourse, then they are zero.

MR GLEDHILL: I cannot say to your Lordship they will be zero, but they will certainly be much less than that. It is just possible there might be some instances where Lendy received recoveries and didn't pass them on.

HIS HONOUR JUDGE RAWLINGS: Okay.

MR GLEDHILL: Then the next biggest creditor after them, and in fact the biggest if you knock out the M1 creditors, the Model 1 creditors, is the cost of the administration, and your Lordship sees that stated as at 23 May 2021 at £6.5 million.

HIS HONOUR JUDGE RAWLINGS: That's going to come out first whatever happens.

MR GLEDHILL: Yes, from assets in the estate.

HIS HONOUR JUDGE RAWLINGS: The costs of the administration won't suffer as a result of my decision.

MR GLEDHILL: No, that seems to be correct because there are £21.1 million of asset realisations in the kitty. And the same would seem to hold good for the HMRC claims to

the extent that they are also administration expense claims.
HIS HONOUR JUDGE RAWLINGS: (inaudible) 2 million that comes out.
MR GLEDHILL: Yes. And then the unsecured creditors have 1.3 —— just under 1.4 million for trade creditors, and it won't escape your Lordship's attention in the line immediately beneath that 1.3 million figure that —— either comprises or in addition to it, there is a £600,000 proof by LGL. That's the parent company. That's the vehicle for Mr Gordon and Mr Brooke, who the administrators are suing for fraud. As I understand it, that is in respect of loans allegedly made before administration. So they will be a significant beneficiary from any enhanced unsecured dividend that is payable with monies dispensed to Lendy under the trust.
And then your Lordship sees there is also a figure for FCA remediation, £1 million. Just to help your Lordship, you can chase down the reference afterwards if it's necessary to do so, but basically what happened here was that there were various Model 2 Investors who were buying loan portions on the secondary market, despite the fact that the relevant loan was in trouble, it may even have gone into default by the time they bought in.

And one of the many criticisms that the FCA made is they ought to have been told, unsurprisingly, before buying loans at par value, that the loans were already distressed. So that £1 million figure there is in fact a figure for amounts that would otherwise be payable to Model 2 Investors as well.
HIS HONOUR JUDGE RAWLINGS: Does that mean that the FCA has paid that and is seeking to get it back again?
MR GLEDHILL: Not as far as I'm aware. I looked at the underlying paragraphs of Mr Webb's witness statement referred to in that note, paragraphs 65 through 67, and I didn't understand that to be saying that the FCA had paid and was then subrogated. And in fact as far as I know, it wouldn't do that. It's not like the financial services compensation scheme.
HIS HONOUR JUDGE RAWLINGS: Shouldn't do, no.
MR GLEDHILL: I think what it did was to impose a restitution order on Lendy, which Lendy evidently hadn't fulfilled by the time of administration.
HIS HONOUR JUDGE RAWLINGS: But don't these same people, if they are the current transferees of the Model 2 loan, don't they benefit from having the money allocated as you urged me to do?
MR GLEDHILL: That's exactly my point. That's exactly my point.

HIS HONOUR JUDGE RAWLINGS: Okay. Fine.
MR GLEDHILL: So if you asked one of the notional beneficiaries of this compensation, "Would you like to have an unsecured claim for your compensation or would you like to have an enhanced payment under the security waterfall from the trustee?", the answer is obvious, it's going to be the latter.
HIS HONOUR JUDGE RAWLINGS: So there may be a proportion there that would be secured. We don't know how much but —— okay.
MR GLEDHILL: Just in relation to the unsecured creditors, we don't get any breakdown of who else other than the parent companies in that £1.4 million odd. One point I did pick up, reading Mr Webb's witness statement, is that there are or there is reference in that to the fact that the former Finance Director of Lendy as at the date of that statement, July of last year, was pursuing unfair dismissal claims against Lendy, which obviously opens up the possibility that some other of these trade creditors are also Lendy insiders, if I can put it that way. We just don't know.
So, my Lord, those are the principles and that's all I'm going to say about the background. And I am now going to make submissions to your Lordship about the reasons why we say that the discretion under this trust

should be exercised in the way in which I have proposed, and I make five points.
The first and the most important consideration is that many of the Model 2 Investors are likely, like Mr Melton, to be retired and to be unable to replace capital losses that they have sustained. Some of them will be elderly. Many, like Mr Powell, who you will remember is a part—time sales assistant at HMV, are likely to be of limited means.
Those persons are likely to have been hit hard by the losses to capital which they have sustained, and I respectfully suggest that a trustee should be doing its best to assist them.
On the other side of the coin, your Lordship has no evidence suggesting that any particular hardship will be caused to unsecured creditors if you deny Lendy participation in the fund in the way that I have suggested.
HIS HONOUR JUDGE RAWLINGS: Yes, although in the event that Model 1 investors do have those unsecured claims, then the profile of them is likely to be similar to the profile of the Model 2.
MR GLEDHILL: I accept that. I accept that. It is a much smaller class, in the region of one—tenth, but I have to accept that the same points that I have just made might

apply to that residual class of M1 investors.

The second point of the five is the one that I have just made to your Lordship by reference to the Shoosmiths' outcome statement, that a significant proportion of the unsecured debt appears to be owed to Lendy insiders. The reference in Mr Webb's witness statement to the unfair proceedings by Kieran O'Connor, the former Finance Director, was Webb 2, paragraph 43I. £600,000 proof by LGL, the holding company.

And your Lordship bears in mind that even if the administrators succeed in fraud claims against Mr Brooke and Mr Gordon, those claims would not be eligible for set-off if LGL truly has debts in respect of pre-litigation funding, which had excluded -- there would be a problem with mutuality, obviously.

And I suggest to your Lordship that it will be an unfortunate result which Model 2 Investors are likely to find unpalatable, if Lendy is allowed to rank pari passu with their claims under the trust, if the consequence of that will be to swell the dividend for distribution to creditors, including some of those who were involved in this saga before the balloon went up and it went into administration.

Third point, your Lordship, is one that we made in our skeleton argument. It is to be assumed that Lendy's

unsecured creditors freely ran a risk on Lendy's insolvency. Model 2 Lenders most emphatically did not run that risk. And I showed your Lordship earlier that when Model 2 was introduced, the investors were told that their security would be held in SSSHL and that the whole point of that quite specifically was to immunise them from the consequences of Lendy's bankruptcy.

When I took your Lordship to Lord Justice Chadwick's decision in Edge, I drew your attention to his comment that one begins by identifying the main purpose of the trust, what those who set it up were seeking to achieve. And I suggest that when your Lordship looks at the announcement that was originally made to the investors about the reason for putting security behind SSSHL, the answer to that is clear. It was to immunise the Model 2 Lenders from the consequence of Lendy's insolvency.

They were told at the outset that SSSHL would hold the security on bare trust. No mention was made at that stage of Lendy having competing claims under it. No mention was made to them that the trustee had a discretion to pay Lendy either an advance or pari passu with their claims. And I suggest that that is an important point in the context of your overall discretionary exercise.

Fourth point. It will not have escaped your

Lordship's attention that in inviting you to direct a pari passu distribution to Lendy and the Model 2 Investors, the administrators are effectively inviting either you to renege or inviting you to allow them to renege on the clear assurances which Lendy gave the Financial Conduct Authority in March 2018 that lenders would take priority. I do not in any way criticise the administrators for taking that position. It's a directions application and it is their obligation to give the court the benefit of adversarial argument on that point.

But we do question whether it could possibly be right for this court to go down that road. Lendy gave the Authority categoric assurances that lenders would come first. It said the same in the first recovery policy which they disseminated to the investor community in April 2018, and as far as the evidence goes, that was fundamental to their subsequently obtaining authorisation from the Authority in July 2018.

We respectfully suggest to your Lordship it could not be right to accede to the administrator's suggestion that you should resile from those assurances or allow Lendy to resile from the assurances it gave to the regulator as part of the price for continuing in business as a regulated entity at all. No trustee

should do that. Still less, with appropriate respect, should a court when asked to put itself into the shoes of a trustee.

Fifth point. We suggest to your Lordship, as well as that specific point, that Lendy's more general misconduct is also a factor of some relevance. My Lord has seen reference to it in some of the FCA correspondence, though you have not been taken by all means to the full volume of the material dealing with that point. Your Lordship has seen in particular the concern that the FCA expressed from time to time about whether Lendy was mis-selling, which resulted, among other things, in Lendy's forced change of name from the misleading Saving Stream name to Lendy. And in our skeleton argument, perhaps if your Lordship can take that out and turn up page 49.

In our skeleton argument on page 49, we made the point that even that, even when it made that concession, the way that it characterised it to its investor community was thoroughly misleading. Looking at page 49, paragraph 55.3, so Lendy's response to that first letter, that was the letter that I read to your Lordship about the Authority referring to the inappropriateness of using the word "Saving Stream" as the tag for this product:

"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 ..."

Then 55.4:

"Lendy replied on the 2 September 2016 deadline, initially declining to comply with the FCA's direction ... but an internal document dating from 1 December 2016 ... 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 ...'."

Your Lordship sees paragraph 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'."

Thoroughly disingenuous. And I make the point to your Lordship, in light of that point and many other like it, that the wider public may find it very difficult to understand why any portion of the trust monies held by SSSHL should go to the Lendy estate, given that Lendy was itself responsible for getting the Model 2 Investors into this mess.

And for the reason that I have already given to your Lordship, it is simply no answer to say that Lendy is now insolvent. As I have explained, the whole point of constituting SSSHL the trustee, rather than Lendy, as it had been under Model 1, was specifically to immunise the Model 2 Investors from the adverse consequences of a potential Lendy insolvency.

My Lord, those are my submissions on that final subject.

HIS HONOUR JUDGE RAWLINGS: Thank you. Ms Toube, what do you want to come back on?

Reply Submissions on Issue 10 by MS TOUBE

MS TOUBE: My Lord, as we saw from the points that my learned friend ended with, much of his submissions are based effectively on an assumption that one should punish Lendy for its, to put it mildly, poor behaviour for the representations which it made to the FCA and possibly also to its investors. There is no doubt that

the Model 2 Investors, and no doubt also the Model 1 Investors, will feel quite strongly about issues such as that. But contrary to what my learned friend says, it does make all the difference that Lendy is now insolvent.

This is not an issue which depends upon punishing Lendy, punishing those who were its directors, or dealing with misrepresentation claims which may be brought in the future.

Lendy itself has unsecured creditors. It is the statutory trustee, indeed, for those unsecured creditors, holding them on the statutory trust. I should correct one point. That 21.1 million includes the asset realisations on the Model 2 Loans. So when it says Lendy's administration, of course some of those are the exact loans that we're talking about here, held within SSSHL.

I have asked my instructing solicitors what is held outside that, and the answer is about 4.5 million. So there is not a large pot of money sitting there in Lendy's estate outside these sums.

Now, of course, my learned friend is right that say one has a loan of £100, one recovers £60 of it. The Model 2 Investors may in some cases be asking for £55 of it. So there may be a trickle down into the Lendy

estate of some small sums. But if the Model 2 Investors' argument is correct, the vast majority of the sums held by SSSHL will go to the Model 2 Investors in preference to the unsecured creditors, and indeed the expense creditors in Lendy's estate.

And those include more than £5 million worth of liabilities to HMRC, who cannot in any sense be called insiders or people who ran the risk of non-recovery.

It also includes the Model 1 Investors who either are not limited recourse for the reasons we've explained, or will in any event potentially have misrepresentation claims. So those Model 1 Investors are not Lendy insiders who should be punished in the way in which my learned friend suggests that that should be the case.

So I'll come back to those points again at the end, if I might. But I think it's important to bear that in mind that no doubt it is true that the Model 2 Investors wish all this money to go to them. They might even have thought that they were entitled to have it all to go to them. The question is, however, how should SSSHL exercise its discretion?

HIS HONOUR JUDGE RAWLINGS: You say it makes all the difference in the world, and obviously, why does it make a difference at all? I think Mr Gledhill says, well,

hang on a minute, you should exercise your discretion in favour of the Model 2 Investors, because they are a much more sympathetic bunch than the other unsecured creditors of Lendy who will be getting the money if you don't do that.

So he said that. Why should it make all the difference in the world that Lendy is insolvent as to how the discretion is exercised?

MS TOUBE: Well, your Lordship knows my primary submission is that one shouldn't be having regard to these factors at all, because the main purpose of this trust was to pay the beneficiaries. The beneficiaries were the Model 2 Investors and Lendy. If one has a shortfall, a general principle should be that you should treat them evenly handed, if there is nothing to suggest that you should treat them otherwise than evenly handed. There is nothing that suggests you should treat them otherwise than evenly handed; that's the answer.

But the point I was dealing with there is my learned friend says: ah, well, the main purpose was in fact to pay the Model 2 Investors first. I don't accept that for a moment. And, because Lendy behaved so badly, when a trustee is exercising its discretion, it should exercise its discretion against Lendy. And I say, well, if that were right, which as your Lordship knows I say

it is not, it makes all the difference in the world that Lendy is insolvent, because when you say Lendy, you mean the insolvent estate of Lendy, which means you mean the unsecured creditors of Lendy.

HIS HONOUR JUDGE RAWLINGS: That's true, but he then goes and has a look at the unsecured creditors of Lendy and says, well, actually some of them are associates, some of them were tied up in all the misrepresentations that they made. So you say they're unsecured creditors as if that is somehow —— that they are somehow more meritorious than Lendy would be if it was a solvent trading company.

But Mr Gledhill goes beyond that and says, look at the unsecured creditors, they include the holding company, they include a former financial director who are substantial creditors who will benefit, and who were tied up in the bad behaviour of Lendy.

MS TOUBE: Well, I should say —— we do dispute those claims. So these are the claims that, for example, that £600,000 had been advitted for voting purposes. There are all sorts of counterclaims and cross—claims and disputes on quantum in relation to those claims.

HIS HONOUR JUDGE RAWLINGS: Fine.

MS TOUBE: So —— and in any event, in the grand scheme of things, looking at what those unsecured —— the insolvent

estate is, those are very small. The largest claims, apart from the costs, are HMRC and the Model 1s. So it cannot be right for a trustee to exercise its discretion to deny payment to an entire class of creditors because it is possible that a small proportion of those may be people involved in bad behaviour.

HIS HONOUR JUDGE RAWLINGS: Okay.

MS TOUBE: Because if and insofar as they were involved in bad behaviour, there are claims, as you know, that are being made against them. And of course there are the misrepresentation claims.

So all of the factors which my learned friend relies on may well give rise to additional claims which the Model 2 Investors have. And my learned friend says, ah, well, they just give rise to personal claims that —— we don't want them as much as we want the money. To which the answer is, of course you would rather have all of the money, but that is not an answer to the point. The real complaints that you have are against Lendy which entitle you to make claims for breach of statutory duty or misrepresentation etc. But they don't entitle you to take the entire element of the shortfall to pay yourselves off first.

And SSSHL was not regulated by the FCA. SSSHL did not make any representations to the FCA. SSSHL did not

make any representations to the Model 2 Investors. The question is ——

HIS HONOUR JUDGE RAWLINGS: Why would that be relevant? It's just the trustee exercising the discretion.

MS TOUBE: Yes.

HIS HONOUR JUDGE RAWLINGS: So if at the moment (inaudible) under the microscope, it's the beneficiary's behaviour, if at all.

MS TOUBE: Yes, the point I was making was, I suppose that I could conceive of an argument which could be made if Lendy were the trustee and also the beneficiary. But it is SSSHL, which is a different company with its own creditors.

HIS HONOUR JUDGE RAWLINGS: All right.

MS TOUBE: So it does boil down to the point which your Lordship put to me earlier which is: do you accept that the bad behaviour of one beneficiary is something that can and indeed, according to Mr Gledhill, should be relied upon to deny its estate any recovery at all until the Model 2 Investors have been paid off in full.

And effectively what my learned friend says is, yes, you can take into account a selection of things which would entitle you to make a claim against that beneficiary to disentitle their insolvent estate to everything, and we say that's just not right.

And so in that regard the cases upon which my learned friend relies, which are cases where it entitles a trustee to make a decision about what to do, for example in the Edge case there was no shortfall there was a surplus which it was distributing, it was entitled to take a decision about where to put that surplus. Whereas here you've got a shortfall in a trust where the main purpose was said to be to pay the beneficiaries without determining which one of them one should pay.

HIS HONOUR JUDGE RAWLINGS: Yes.

MS TOUBE: And so that I think really deals with almost all the points I wanted to make.

I'm just looking at the basis on which my learned friend said that discretion should be exercised in favour of the Model 2 Investors. The first point was the Model 2 Investors are, or at least some of them are, disadvantaged. And we accept, we absolutely accept that people like Mr and Mrs Melton in particular have lost their life savings. And it is absolutely the case that both Model 1 and Model 2 Investors, who are not going to be able to recover in full from this company, will be disadvantaged. Some of them may lose their life savings. Other people like Ms Taylor being more sophisticated with less loss. But that is not a basis on which SSSHL should exercise its discretion.

HIS HONOUR JUDGE RAWLINGS: Well, nor even a factor you say.

MS TOUBE: Nor even a factor.

HIS HONOUR JUDGE RAWLINGS: Okay.

MS TOUBE: But if it were a factor it isn't a factor that points only in one direction, if I can put it that way.

I have already dealt with his second point which is some of the unsecured debt is for Lendy insiders, because of course the answer is: but most of them weren't.

And the third point was unsecured creditors ran the risk, whereas he says Model 2 Investors did not, they thought they were going to be paid out in full. And the answer to that, apart from all the documents which your Lordship has already seen, warning the Model 2 Investors of the risks. It certainly can't be said for example HMRC chose to run the risk of not being paid.

The fourth point he made was that the administrator should not be allowed to renege on Lendy's representations. But the administrators are the SSSHL administrators and they are not infected by Lendy's representations.

HIS HONOUR JUDGE RAWLINGS: Yes, I think the point was -- yes. Right, I suppose in the wider sense he is saying that the party who made the representations should not be favoured with a proportion of the default interest

which would be contrary to the representations they made. Perhaps "renege" isn't entirely the right word, but I get the general point that he was making, which is that it seems that providing Lendy with some proportion of the default interest would be something that they had represented that they would not have.

MS TOUBE: Yes. So the first point is, it depends what answer you give in relation to default interest.

HIS HONOUR JUDGE RAWLINGS: Yes.

MS TOUBE: The second point is -- so if my learned friend is right, Lendy is not getting any default interest. If Lendy does get default interest that's because the contract provided on its proper construction for Lendy to get its default interest. And Lendy, whatever Lendy said to the FCA, that is what the contract provided for.

HIS HONOUR JUDGE RAWLINGS: Yes.

MS TOUBE: There may be claims, as I have said before, against Lendy for breach of statutory duty or for misrepresentation, but given that Lendy means the unsecured creditors of Lendy they cannot be infected by Lendy's misrepresentations.

So in that context it makes all the difference in the world that Lendy is insolvent, if this is a relevant factor at all, which we say it's not.

And the same point is made in relation to Lendy's

misconduct. And again my learned friend says there, well that the Model 2 Investors and the market would think this was a terrible thing to happen if a discretion were exercised in this way, and even more so by the court. And the answer is, well holding that over the court's head cannot be appropriate in these circumstances where this is not about rewarding the lendee, this is about the proper exercise of discretion to two classes of beneficiaries where one of them, Lendy's unsecured creditors, are no more, if I can put it this way, "the bad guys" than the Model 2 Investors. HMRC, the Model 1 Investors, the administrators for their costs, these are not people who are infected by what Lendy did prior to administration.

So my Lord I think that deals with all the points that my learned friend made that I hadn't already dealt with in opening.

HIS HONOUR JUDGE RAWLINGS: Yes. All right. Thank you. Is there anything else?

MS TOUBE: No, my Lord, nothing more from me.

HIS HONOUR JUDGE RAWLINGS: All right. At this point in the proceedings I normally try to give some indication of when I might hand down judgment. I hope it will come as no surprise that I'm not going to do anything other than reserve judgment, rather than sculling forth with my

answers now.

It is possible that I may be able to send out a draft of the judgment in about six weeks' time. That is possible. If it's not then, then it's more likely to be 12 weeks' time because of commitments I have there.

In terms of distributing the draft judgment, Mr Gledhill and Ms Toube or other counsel, are you away? Because I normally would just send it to counsel and then provide for them to disseminate it. Once it's available I would intend to send it out, but if either of you are away for periods then it may be best for you to provide those details so that I know who I might send it to in the alternative. Obviously you both have juniors that I could send it to.

Do you know whether there are any dates —— sorry for the difficult question —— when both you and your juniors are away? If there are and you are unable to answer that immediately, if you just e—mail my clerk to say actually this is when I am away, this is when my junior is away, and I can get some indication of who it would be best to send the draft judgment to, once it's available.

As I say, I'm probably not really going to be able to produce it until at least the beginning of August, but if not then, then more like the end of September or

beginning of October. So if you could send to my clerk's e—mail address details of when you and your juniors are away so that I know the best person to send the draft judgment to when it's available. And I am only looking for when you are away in August and September really.

MS TOUBE: My Lord, I can certainly give that to you, although I can say that even if I'm away I will have access to my e—mails so I can circulate it then in any event.

MR GLEDHILL: The same will go for me and Mr Conte. In practical terms if your Lordship sends the draft to Ms Toube and Mr Perkins and to me and Mr Conte it will get to where it needs to get to. Even if we are away we will be on e—mail.

HIS HONOUR JUDGE RAWLINGS: Then don't worry about it. Provided you have that confidence I shall send it to all four of you and then I trust that it will get to the right place. And obviously the instructions as to what to do and to come back as usual with comments etc will come out with the draft judgment.

All right, if there is nothing else we can end at that point, one hour and six minutes ahead of schedule I think.

MS TOUBE: Thank you very much, my Lord.

MR GLEDHILL: I'm grateful to your Lordship. Thank you.

(2.55 pm)

(The hearing concluded)

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