Neutral Citation Number: [2021] EWHC 760 (Admin)

Case No: CO/1176/2020

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
ADMINISTRATIVE COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 29/03/2021

Before :

THE HON. MR JUSTICE BOURNE

- -

Between :

THE QUEEN
on the application of
(1) EMMET DONEGAN
(2) JOANNE ELLIS-CLARKE
(3) ALAN CONSIDINE
(4) NATHAN BROWN

Claimants

- and -

FINANCIAL SERVICES COMPENSATION SCHEME LIMITED **Defendant**

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- -

James McClelland, Tim Johnston and Charlotte Thomas (instructed by **Shearman & Sterling LLP**) for the **Claimants**
Richard Handyside QC, Rupert Allen and Rebecca Loveridge (instructed by **Dentons UK & Middle East LLP**) for the **Defendant**

Hearing dates: 19-21 January 2021

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

....

MR JUSTICE BOURNE

Covid-19 Protocol: This judgment was handed down by the judge remotely by circulation to the parties' representatives by email and release to Bailii. The date and time for hand-down is deemed to be Monday 29th March 2021 at 10.00am.

The Hon. Mr Justice Bourne :

Introduction

1. By this claim for judicial review the Claimants challenge a decision announced by the Defendant on 9 January 2020 ("the Decision"), stating that it would not pay compensation to a category of investors who had suffered losses arising from the collapse of London Capital & Finance PLC ("LCF").

2. The Claimants are investors who purchased securitised bonds ("the Bonds") from LCF.

3. The Defendant operates the scheme set up by the Financial Conduct Authority ("FCA") under section 213(a) of the Financial Services and Markets Act 2000 ("FSMA") for compensating people in respect of unsatisfied claims made "in connection with a regulated activity carried on … by relevant persons".

4. The basis for the Decision was that the sale of the Bonds did not fall within any "regulated activity" within the meaning of that section. As will be further explained, that was because the Bonds were said not to be "transferable securities", in particular because the Bond documentation contained clauses stating that they could not be transferred.

5. The Claimants contend that, as a matter of law, the Bonds were transferable securities and/or that LCF in any event engaged in the regulated activity of agreeing to deal in transferable securities even if the Bonds themselves were not transferable.

6. It is of note that the FCA's regulation of LCF has very recently been the subject of an independent investigation. The investigation report by Dame Elizabeth Gloster, dated 23 November 2020 and revised on 10 December 2020 ("the Gloster Report"), was published not long before this hearing took place. In that report Dame Elizabeth expresses her opinion on the central legal question with which I am concerned, concluding that the issuance of LCF's bonds did not constitute "regulated activity". Dame Elizabeth also however described the issue as "finely balanced" and, of course, acknowledged that it will be for the Courts in this and any other litigation to make an authoritative determination. It should also be noted that Dame Elizabeth did not express any view on the arguments which form the Claimants' Grounds 2 and 3, and did not see all of the pleadings or skeleton arguments which are before me.

7. I note also that, following the Gloster Report, HM Treasury has announced that it intends to set up a compensation scheme for LCF bondholders. However, the scope and extent of such a scheme are not yet known, and this development does not materially affect the questions which I have to decide.

Confidentiality

8. On 9 October 2020, Morris J made an order protecting confidentiality in relation to certain "Private Information" defined in that order and consisting of certain personal data, financial information and other personal information which are contained in some claim documents and which are not central to the issues being determined. Essentially the order restricts access to, and the use outside these proceedings of,

documents containing unredacted Private Information Further applications, dated 30 October 2020, 30 November 2020 and 18 January 2021, were made to me by the Claimants, for orders that certain further information, including the final sentence of paragraph 3 of their skeleton argument dated 14 December 2020, be treated as Private Information for the purpose of the order of 9 October 2020. Those applications were not actively opposed and are consistent with an order already made in proceedings concerning LCF, and accordingly I made the orders sought at the conclusion of the hearing.

Factual background

9. LCF was a financial institution, authorised by the FCA from 7 June 2016, and registered with HMRC as an ISA manager[1] from 1 November 2017.

10. LCF raised finance by issuing securitised bonds, many of which were described as ISA products. Over 11,600 investors, mostly individuals, invested a total of more than £237m. LCF's documentation explained that these funds would be invested in various UK companies, usually also by way of bonds, and that the revenue from those investments would be used to make regular interest payments ("coupons") to the investors.

11. Unfortunately there is reason to believe that the funds have been dissipated. LCF ceased trading in December 2018 and went into administration on 30 January 2019. An Administrators' Report in March 2019 referred to "a number of highly suspicious transactions involving a small group of connected people which have led to large sums of the Bondholders' money ending up in their personal possession or control". Very little of any investors' capital has been recovered and the Administrators have estimated that as little as 25% will ultimately be recouped.

12. Many of the investors were neither wealthy nor experienced or sophisticated in financial affairs. Some are people of modest means who invested their life savings.

13. Many of LCF's customers had compensation claims arising from what were demonstrably regulated activities, such as arranging deals in investments or advising on investments. As at 16 December 2020 the Defendant had paid compensation to around 22% of LCF's customers on this basis.

14. However, the effect of the Decision is to refuse to compensate those claims made by the majority of holders of the Bonds, which are on the basis that by merely issuing the Bonds (from 3 January 2018 onwards) LCF was engaging in the regulated activity of dealing in investments as principal.

Legal background

15. Section 213(1) of FSMA, which implements the Investor Compensation Scheme Directive (97/9/EC) (investments) and the Deposit Guarantee Schemes Directive (2014/49/EU) (deposit-taking), empowers the FCA to:

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[1] Individual Savings Accounts or ISAs are a vehicle by which UK residents can make tax-free savings within certain annual limits. The managers of such accounts are required to be approved under the Individual Savings Account Regulations 1998 (SI 1998/1870 as amended) and the accounts themselves must comply with various requirements in those Regulations.

> "establish a scheme for compensating persons in cases where … relevant persons are unable, or likely to be unable, to satisfy claims against them".

16. That scheme is operated by the FSCS, as I have said. Section 213(3) of FSMA requires the FSCS to:

> "… assess and pay compensation, in accordance with the scheme, to claimants in respect of claims made in connection with – (i) a regulated activity carried on (whether or not with permission) by relevant persons …".

17. Section 213(9) of FSMA defines "relevant persons" as including:

> "a person who was – (a) an authorised person at the time the act or omission giving rise to the claim against him…took place…"

The definition covers all persons with FCA authorisation, which included LCF at the material time.

18. Section 22 of FSMA defines "regulated activity" as:

> "an activity of a specified kind which is carried on by way of business and –
>
> (a) relates to an investment of a specified kind…".

By section 22(5), "specified" means specified in an order made by the Treasury.

19. The relevant order is the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544), as amended ("the RAO").

20. Article 4(1) of the RAO states that "the following provisions of this Part specify kinds of activity" which will be regulated, but Article 4(3) makes each kind of activity subject to any stated exclusions.

21. Article 14 of the RAO provides that "buying, selling, subscribing for or underwriting securities or contractually based investments … as principal", commonly referred to as "dealing in investments as principal", is a regulated activity.

22. Article 64 of the RAO also makes "agreeing to carry on an activity of the kind specified by any other provision of this Part", including Article 14 (but not a number of other Articles), a regulated activity.

23. The relevant FSMA provisions are reflected in the FCA's rules for the Defendant which are published in the COMP section of the FCA Handbook. To be covered by FSCS compensation, an activity must fall within the definition of "protected investment business" at COMP 5.5.1, which includes "designated investment business". The latter phrase is defined in the FCA Handbook Glossary by reference to regulated activities, including dealing in investments under RAO Article 14 and agreeing to deal in investments as principal under RAO Article 64.

24. The parties agree that, prior to 3 January 2018, Article 18 of the RAO ensured that issuing the Bonds could not fall within Article 14, because it excluded from the scope of regulated activities "the issue by any person of his own debentures". "Debentures" were defined by reference to "instruments creating or acknowledging indebtedness" specified in Article 77. I am told that the purpose of this exclusion was to enable companies in general to raise money for their business by issuing their own securities without taking on regulatory burdens as a result.

25. To give effect to the second Markets in Financial Instruments Directive (Directive 2014/65/EU, "MiFID 2"), the RAO was amended by the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2017 (SI 2017/488) with effect from 3 January 2018.

26. The amendment introduced Article 4(4) of the RAO, which provides:

> "Where an investment firm or credit institution –
>
> (a) provides or performs investment services and activities on a professional basis; and
>
> (b) in doing so would be treated as carrying on an activity of a kind specified by a provision of this Part but for an exclusion in any of articles 15 …, 18 ...,
>
> that exclusion is to be disregarded and, accordingly, the investment firm or credit institution is to be treated as carrying on an activity of the kind specified by the provision in question."

27. The Article 18 exclusion was thereby undone, with effect from 3 January 2018, in respect of "investment services and activities". In this way a distinction was drawn between companies in general raising money for their business by issuing their own securities, and investment firms selling their own securities with a view to profit. The latter activity would be regulated.

28. Article 3 of the RAO defined "investment services and activities" as including services and activities listed in Section A of Annex 1 to MiFID 2.

29. By virtue of paragraphs (2) and (3) of Section A of Annex 1, those services and activities included "execution of orders on behalf of clients" and "dealing on own account".

30. Those phrases are defined in, respectively, Article 4.1(5) and (6) of MiFID 2. The first means concluding agreements to buy or sell "financial instruments" on behalf of clients, and the second means trading against proprietary capital resulting in the conclusion of transactions in "financial instruments".

31. By Article 4.1(15), read with Section C of Annex 1 of MiFID 2, "financial instruments" are any of 11 classes of instrument. It appears to be common ground that the relevant class is "transferable securities".

32. By that tortuous route, it emerges that the relevant activity will only be a regulated activity by virtue of Article 14 of the RAO, and thereby fall within the scope of FSCS compensation, if it concerns "transferable securities".

33. Transferable securities are defined by Article 4.1(44) of MiFID 2 as:

> "… those classes of securities which are negotiable on the capital market, with the exception of instruments of payment, such as:
>
> (a) shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares;
>
> (b) bonds or other forms of securitised debt, including depositary receipts in respect of such securities;
>
> (c) any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures".

34. The key question is therefore whether LCF either (1) by dealing in the bonds was dealing in "transferable securities" so as to fall within RAO Article 14, or alternatively (2) agreed to carry on an activity falling within Article 14, so as to fall within Article 64.

The Defendant's Decision

35. Before LCF went into administration, the Defendant's officials informed some investors, or potential investors, that LCF was authorised by the FCA and therefore covered by the FSCS up to the compensation limit of £50,000. It is regrettable if anyone was thereby misled, but nothing turns on it for present purposes.

36. On 6 March 2019, the Defendant expressed a provisional view that the Bonds were not "transferable securities" and had not been the subject of any advice given by LCF, and therefore that LCF had not carried on any regulated activity and investors accordingly were not eligible for any FSCS compensation. This provisional view was repeated from time to time in correspondence.

37. On 9 January 2020 the Defendant made a formal announcement which stated:

> "FSCS is now ready to announce its key decisions for claims in relation to the London Capital and Finance (LCF) failure. FSCS will protect the 159 bondholders who switched from stocks and shares ISAs to LCF bonds. Customers in this category do not need to take any action. We will pay compensation to these customers by the end of February 2020.
>
> FSCS is unable to protect the 283 bondholders who dealt with LCF before it was authorised to carry out financial services

> business (on 7 June 2016). We will contact these customers to confirm this.
>
> While FSCS maintains that the act of issuing mini bonds is not a regulated activity, and is therefore not something we protect, we have concluded there will be some customers who were given misleading advice by LCF and so have valid claims for compensation.
>
> However, we expect that many customers will not be eligible for compensation on this basis. We will provide a further communication with details of when and how customers in this category can submit their claims. We will aim to start reviewing these advice claims in the first quarter of 2020. ….
>
> [B]ased on our investigations so far, we believe many LCF customers are unlikely to be eligible for compensation on the basis of misleading advice."

38. By 1 October 2020, the Defendant had paid compensation to 1,568 investors, around 13.5% of the total, in respect of claims arising from advice. An up-to-date total of 160 investors were held to be entitled to compensation on the basis that they had transferred into the Bonds from existing stocks and shares ISAs.

The Grounds of Challenge

39. The Claimants seek to rely on a Re-Amended Statement of Facts and Grounds filed on 30 October 2020, and the Defendant on 21 December 2020 applied for permission to file Re-Amended Grounds in response. Permission to amend in each case is not opposed and I hereby grant it.

40. There are three Grounds on which the Claimants argue that the Decision was unlawful:

    1. The Defendant was wrong to decide that the Bonds were not "transferable securities". Bonds, as a class, fall within the scope of that term. On a proper construction of the legislation, the insertion of a no-transfer provision into a bond does not remove it from that class.

    2. Alternatively, the no-transfer clauses are "unfair", and therefore ineffective, pursuant to the Consumer Rights Act 2015 ("CRA"). All of the Bonds could have been transferred and, accordingly, qualified as transferable securities ("Ground 2A"). Alternatively, that is true of the ISA Bonds in view of their particular terms and circumstances. Further and in any event, in the case of the ISA Bonds, the effect of the CRA's interpretative provisions is that the no-transfer clauses must be read as subject to the ISA provisions, allowing those Bonds to qualify as transferable securities ("Ground 2B").

    3. In the further alternative, on a proper construction of the subscription agreements between LCF and its investors when read subject to the CRA, LCF agreed to provide investors with transferable Bonds and therefore carried on

the regulated activity, under RAO Article 64, of agreeing to deal in investments as principal.

41. Before considering each Ground in turn, it is necessary to examine the terms and conditions of the Bonds and the documentation associated with them.

The Bonds

42. Between September 2013 and December 2018, LCF marketed fourteen series of bonds of which four series were marketed as being ISA-eligible. Four of the non-ISA bond series were sold entirely before 3 January 2018 and are therefore not relevant to this case. Some bonds in the remaining series may have been sold before that date, though that will not affect my resolution of the issues of law.

43. Mr Handyside QC describes the Bonds as “mini-bonds”, a term which he defines as “unlisted debt securities that are typically issued by small businesses to raise funds and which are usually illiquid as they are not, or not easily, traded”. For the purposes of my analysis, it does not matter whether the right term is “bond” or “mini-bond”. What matters is the precise nature of the instruments sold and the meaning of the legal provisions applicable to them.

44. Each bond series gave rise to a number of documents. There were brochures, information memoranda, bond instruments and bond certificates. Not all of those documents have been retrieved, and I cannot be certain that each of the four types of document existed for every bond. I have been shown the full suite of documents relating to one series of non-ISA bonds (Series 10), and documents variously relating to two of the ISA-eligible series (Series 2 and 3).

45. Different arguments apply to the ISA and non-ISA bonds but, save in that respect, neither party has sought to persuade me that any variations between the documents, or the available documents, for different series are material.

46. I now consider significant features from a set of documents relating to each type of bond. In the following summary I refer to those features which were particularly drawn to my attention in submissions. Save for the references to ISA status, the terms and conditions appear broadly similar in the two types of bond and this summary is not intended to highlight any difference.

<u>The non-ISA Bonds</u>

47. I was shown the marketing brochure for the Series 10 bonds. On the front cover the document is entitled:

> “3-year
> 8.0% Income Bonds
> (Non-Transferable Securities)
> Series 10
> A simple and transparent investment”.

48. The brochure begins with a statement in large red type: “This section is very important and requires your attention.” There is then a passage in capital letters

stating: "THIS DOCUMENT MUST BE READ IN CONJUNCTION WITH THE INFORMATION MEMORANDUM "(IM)" SPECIFIC TO THE BOND".

49. The brochure goes on to describe itself as a synopsis of the Series 10 Bond offering, and describes the Bond itself as "a Mini Bond, which is a type of loan to a company".

50. Under a heading in large red type which reads "Here are specific risk factors you should consider", the brochure states:

> "Bonds are non-transferable
>
> There is, and will be, no established market for the Bonds as the Bonds are non-transferable and you should not invest if you may need to realise your investment prematurely.
>
> Illiquidity and non-transferability
>
> Investments in unquoted securities … such as these Bonds are illiquid … . The Bonds are non-transferable, so your money is effectively locked in until the Maturity Date of each specific Bond.
>
> …
>
> Financial Services Compensation Scheme
>
> The protections offered by the Financial Services and Markets Act 2000 including recourse to the Financial Ombudsman Service and compensation entitlements under the Financial Services Compensation Scheme do not apply. All prospective Investors and Bondholders are strongly recommended to seek advice on the suitability of this investment."

51. A Disclaimer at the end of the brochure includes the phrase:

> "A detailed presentation of each Bond offered can be found in the Information Memorandum, which has been approved for promotion for the purposes of section 21 of the Financial Services and Markets Act 2000 … by LCF."

52. I was then shown the Series 10 Information Memorandum. It begins with a heading "Important Notice", followed shortly by these words in capital letters:

> "PLEASE NOTE THAT THESE BONDS ARE NOT REGULATED BY THE FINANCIAL CONDUCT AUTHORITY (FCA) AND IS [sic] NOT COVERED BY THE FINANCIAL SERVICES COMPENSATION SCHEME."

53. Later in the same section, under a heading in large red type "Bonds are NOT transferable" it states:

> "The Bonds are not transferable. Investors should therefore be aware that they are effectively 'locked in' to the investment for the intended timescale outlined in this Information Memorandum."

54. In a section entitled "Key Information" the Memorandum states:

> "The Bonds will not be listed or traded on any recognised investment exchange. The Bonds are NOT transferable."

55. Under "Frequently Asked Questions" the Memorandum states:

> "How is a non transferable corporate bond different from a transferable corporate bond?
>
> This Bond is effectively a private borrowing agreement between LCF and a Bondholder that cannot be transferred to someone else. In contrast, transferable corporate bonds are freely tradeable instruments.
>
> Are the Bonds listed?
>
> No, and LCF will not apply for the Bonds to be admitted to trading on any market or exchange.
>
> …
>
> Can I withdraw my money before the end of the term?
>
> No, the Bonds have a fixed term, are not transferable and Bondholders do not have the right to redeem their Bonds prior to the Maturity Date."

56. Under "Risk Factors" the Memorandum states:

> "Risks relating to the Bonds
>
> Financial Services Compensation Scheme
>
> The protections afforded by the Financial Services and Markets Act 2000 including recourse to the Financial Ombudsman Service and compensation entitlements under the Financial Services Compensation Scheme do not apply. All prospective investors and Bondholders are strongly recommended to seek advice on the suitability of this investment.
>
> Bonds are not regulated securities
>
> The Bonds constitute loans to LCF and are not regulated by the Financial Conduct Authority.
>
> Bonds are not transferable

> There is, and will be, no established market for the Bonds as the Bonds are not transferable and you should not invest if you may need to realise your investment prematurely.
>
> Illiquidity and non-transferability
>
> Investments in unquoted securities (i.e. investments not listed or traded on any stock market or exchange) such as the Bonds are illiquid (i.e., they cannot be disposed of prior to the Maturity Date so as to realise cash). The Bonds are non-transferable, so your money is effectively locked in until Maturity Date of each specific Bond."

57. At the end of the Information Memorandum is a section headed "Subscription Agreement for Bonds in London Capital & Finance PLC" which states that potential investors must submit an application to subscribe at least £5,000.

58. I was told by Mr Handyside QC that the application form required the applicant to sign a declaration that they agreed with and would be bound by the terms of the Information Memorandum. His case is that this would amount, in effect, to applicants acknowledging that they were on notice of the information contained in the Information Memorandum, but that the contract terms are nevertheless to be found in the Bond Instrument, to which reference is made in the Certificate received by successful applicants. The Claimants' case, on the other hand, is that the Information Memorandum contained the terms and conditions of the contract.

59. Each of the Bonds was constituted by a Bond Instrument, namely a deed which set out (or purported to set out) terms of the transaction which it stated were binding on LCF and on the bondholder. Each Instrument stated that the bondholder was entitled to a certificate stating the nominal amount of the bond held and a certified copy of the instrument. The Instrument recited key details such as the issue date, repayment date, interest rate and interest periods.

60. Clause 3.3 (in the Series 10 Bond Instrument which I was shown as an example) provides:

> "The Bonds and the Certificates shall be held subject to the terms of this Instrument which shall be binding on the Company and the Bondholders."

61. Clause 2.7 of the Bond Instrument provides:

> "The Bonds shall not be capable of being dealt in on any stock exchange or any other investment exchange in the United Kingdom or elsewhere and accordingly no application shall be made to any such stock exchange or investment exchange for permission to deal in or for an official or other listing in respect of the Bonds."

62. Similarly clause 7, under the heading "Transfer", provides:

> "7.1 The Bonds are not transferable in whole or in part.
>
> 7.2 The Company and the Bondholder shall not be entitled to assign or transfer all or any of its rights, benefits or obligations hereunder save as set out in this Clause 7.
>
> 7.3 Any person becoming entitled to a Bond as a result of the death or bankruptcy of a Bondholder or of any other event giving rise to the transmission of such Bond by operation of law may, upon producing such evidence as reasonably required by the Company be registered as the holder of such Bond.
>
> 7.4 In the case of death by a registered holder of a Bond, the only persons recognised by [sic] Company as having any title to the Bond are the executors or administrators of a deceased sole registered holder of a Bond or such other person or persons as the Company may reasonably determine and, at the absolute discretion of the Company, the Company may at any time repay all or part of the Bond at par without interest."

63. Clause 10 requires LCF to keep a Register of the bondholders and recites that it will recognise the registered holder of any bonds as their absolute owner and "shall not be bound to take notice or see to the execution of any trust … to which any Bonds may be subject".

64. The Bond Certificate is a single page document identifying the registered bondholder and the amount of the holding, signed on behalf of LCF.

<u>The ISA bonds</u>

65. I was also shown the brochure relating to ISA bonds in Series 3 and the Information Memorandum and Bond Instrument relating to Series 2. These contain provisions about non-transferability which are not materially different from those in the documents relating to the Series 10 non-ISA bonds. I will not repeat those references, but will instead focus on provisions relevant to ISA eligibility.

66. The brochure for the Series 3 ISA Bonds states on its cover page, in a large blue circle:

> "8.95%
> 5 year ISA
> Interest paid annually
> Series 3".

67. Page 8 of the brochure contains a similar but larger blue circle, this time emphasising that the 5 year ISA is at a fixed rate and that this is an asset-backed security. An indented black circle asserts that in 2018 this was a "Gold Trusted Service" according to the review platform Feefo.

68. The next page sets out illustrative returns on investments of various amounts. These are shown without deduction of tax, as one would expect with an ISA.

69. A list of "Reasons to Invest" includes: "LCF is authorised and regulated by the Financial Conduct Authority (FCA)".

70. The brochure refers to the "Series 3 ISA offering", the "Series 3 ISA" and "UK fixed-interest IFISAs".

71. Under the heading "Taxation", the brochure states:

> "The statements in this brochure and the associated Information Memorandum are intended to be a brief description of some of the realities of investing in bonds. Potential bondholders should seek their own specialist advice if they are unsure of their taxation position in relation to investing in bonds.
>
> To hold an ISA investment, you are required to remain eligible under HMRC rules. The interest on our innovative ISA's in [sic] tax free. This means that, while you usually pay income tax on interest from other mini bonds, you don't pay any on our ISA bonds. You don't pay any additional personal income tax or capital gains tax on any money you earn from an innovative finance ISA. You don't need to declare any ISA interest as the ISA manager does this for you."

72. This brochure, like that for the non-ISA Series 10, also states that the FSCS Compensation Scheme does not apply, and goes on:

> "**Financial Conduct Authority**
>
> LCF is authorised and regulated by the Financial Conduct Authority (FCA), with FRN 722603. **The bonds are not regulated by the FCA.**"

73. As Mr McClelland points out, the brochure gives no explanation of why these protections do not apply.

74. The Series 2 ISA Bonds Information Memorandum has a definition section which defines "Bonds" as:

> "These Series 2 ISA, 2-year, 6.5% interest bearing securities described herein and offered by LCF subject to this Information Memorandum."

75. Under "Key Information" the Information Memorandum states:

> "**Description of the bonds**
>
> 6.5% (being 5.2% when paid net of basic rate income tax) Sterling corporate bonds due on redemption at the Maturity Date …
>
> **Innovative Finance ISA**

> Investors subject to their own tax position are able to hold the Bonds in the LCF Innovative Finance ISA ('IFISA'), allowing them to benefit from tax free income. The annual ISA allowance can be invested in whole or in part into the LCF IFISA, or existing ISA balances can be transferred into the LCF IFISA.
>
> …
>
> **Withholding tax**
>
> All payments of principal and interest made by LCF in respect of the Bonds may be made subject to deduction for UK income tax, subject to lawful or any customary exception.
>
> Please note that Bond Holders may have to pay additional tax depending on their own tax position.
>
> …
>
> **Interest rate**
>
> The Bonds will bear interest from the date of issue at 6.5% (being 5.2% when interest is paid net of basic rate income tax at 20%). … If the Bonds are held in the LCF IFISA the Investor will receive interest on the Bonds without deduction from the date of issue at 6.5%.
>
> …
>
> **Early redemption**
>
> LCF has the right to redeem any or all of the Bonds in issue early in its discretion (and the Bonds to be redeemed may be selected at the discretion of LCF) and upon such early redemption LCF shall pay to the relevant Bond Holders the principal amount of the relevant Bonds together with accrued interest."

76. Under a separate heading "The LCF Innovative Finance ISA", the Memorandum repeats that the Bonds can be held in the IFISA and goes on to set out some of the rules applicable to ISAs generally. It then states:

> "LCF does not intend to accept any applications for the Bonds and/or the Series 1 ISA Bonds and/or the Series 3 ISA Bonds that are not held in the LCF IFISA."

77. As in the case of the non-ISA bonds, the Subscription Agreement is found at the end of the Information Memorandum. It refers to bonds, defined by reference back to the definition in the Information Memorandum. It includes the Application Form. This has a heading "LCF Innovative Finance ISA Application", and the form states:

> "I apply to subscribe for a LCF Innovative Finance ISA for the current tax year.
>
> I wish to invest the following amount … in LCF Bonds Series 2 ISA 2 year 6.5% Bonds as specified below in respect of new ISA Investment … and transferred ISA Investment."

78. Mr McClelland emphasises that, as well as applying to acquire bonds, applicants by completing this form were simultaneously applying for the ISA wrapper in which the bonds would be held. That can also be seen from the Investor Declaration at the end of the form, in which applicants stated that they have not subscribed and will not subscribe more than the overall ISA subscription limit in the tax year. The signature section recites that the applicant has read and understood and agrees "to the terms and conditions of the LCF Innovative Finance ISA and LCF Bonds".

79. The Bond Instrument for the Series 2 ISA Bonds defines "the Bonds" as "the £100 Series 2 ISA 2 year 6.5% secured bonds constituted by this Instrument or, as the case may be, those £100 Series 2 ISA 2 year 6.5% secured bonds for the time being outstanding".

80. Under "Amount of Bonds" the Bond Instrument states that an "offer for subscription of the Bonds shall be made in accordance with the Offering Memorandum …".

81. The final page of the Bond Instrument is a "form of certificate", but it seems that this was not in fact the certificate which was issued to the holder of ISA Bonds. I have been shown the Certificate which was issued to the Third Claimant in respect of Series 4 ISA Bonds, stating:

> "[name] is the registered holder of 200 Series 4 ISA, 8.0% 3-year secured bonds, Interest to be paid quarterly on the last day of March, June, September, December and upon maturity, subject to the Loan Note Instrument."

Ground 1

82. Mr McClelland submits that the Bonds fell within the definition of "transferable securities" in Article 4.1(44) of MiFID 2, quoted at paragraph 33 above. He points out that the definition refers to "classes of securities" which are negotiable, and that the "classes" are further described by the words "such as … (b) bonds or other forms of securitised debt …".

83. The argument is that the reference to "<u>classes of securities</u> which are …", as opposed to merely "<u>securities</u> which are …" (emphasis added in both cases), means that it is not necessary or appropriate to consider whether an individual security is in fact negotiable on the capital market. Instead, Mr McClelland contends, Article 4.1(44) effectively deems bonds, as a class, to be so negotiable. It does this by including bonds, as a class, in the definition, without any further requirement that an individual bond must in fact be negotiable on the capital market.

84. Mr Handyside, conversely, argues that the words "*those classes of securities which are negotiable on the capital market*" qualify everything else in Article 4.1(44) including sub-paragraphs (a) to (c).

85. As Mr Handyside notes, the examples given in those sub-paragraphs are clearly intended to be non-exhaustive because they are introduced by the words "such as". Sub-paragraph (c) is itself an open-ended sub-category of "any other securities giving the right to acquire or sell such transferable securities …".

86. As a matter of pure textual analysis, it seems to me that the words "*which are negotiable on the capital market*" do indeed qualify everything that follows. Given that introduction, if the word "transferable" were repeated in the sub-paragraphs (so that they referred to "transferable shares …", "transferable bonds …" and "any other transferable securities giving …"), the repeated word would be otiose or superfluous.

87. If it were otherwise, the words "*which are negotiable on the capital market*" would not have a clear function or meaning. In the case of the bonds identified by sub-paragraph (b), those words would either mean nothing, or they would have the vague and apparently inconsequential meaning of an observation to the effect that bonds by their nature are generally transferable (even if the terms of some bonds mean that they are not).

88. I have not been taken to any legal or other definition of "bond" which could persuade me to the contrary conclusion, e.g. by providing any explanation for bonds as a class being included in a list of "transferable securities" regardless of their actual transferability or lack of it. The Claimants' counsel have referred me to several of the legal dictionaries which simply describe a bond as a debt instrument whereby one person binds himself to another for the payment of a specified sum of money either immediately or at a fixed future date (skeleton argument footnote 45). That broad definition in my view does not indicate anything about the transferability or otherwise of bonds in general.

89. External sources do not resolve this question one way or the other.

90. Guidance in the FCA Handbook follows the Defendant's interpretation of the definition, stating that the test is whether an instrument is "negotiable on the capital markets" and that bonds are transferable securities "to the extent they meet this test", but that of course is only an opinion.

91. Mr Handyside also relies on Guidance issued by the European Commission in relation to the definition of transferable securities in MiFID 1 (Directive 2004/39/EC), which was in the same terms as in MiFID 2. That guidance stated that shares would not be "financial instruments" unless they were transferable securities and in particular were "negotiable on the capital market", the latter qualification being described as "the essence of the definition of transferable securities". The Commission's guidance, like that of the FCA, deserves respect and may be persuasive but does not decide the question of law.

92. The same is true of the conclusion drawn in the Gloster Report which concluded on balance that the Bonds were not "transferable securities" within the meaning of MiFID 2 because:

> "(i) First, LCF's bonds were – *de facto* – not tradable on the capital markets. No secondary market existed for these bonds and they were, in reality, not traded.
>
> (ii) Second, the bonds that the Investigation has seen were, by their terms and conditions, expressed to be '*non-transferable*'".[2]

93. Both sides place some reliance on the wording of the Investment Services Directive (Council Directive 93/22/EC) which predated MiFID 1 and MiFID 2 ("the ISD"). Article 1(4) of the ISD defined transferable securities to mean, inter alia:

> "Bonds and other forms of securitised debt
> which are negotiable on the capital market …"

94. If that wording were still applicable, the Claimants' case could not get off the ground. The Defendant relies on it (and on reinforcing wording in recitals (9) and (11) of the ISD) for its consistency with the Defendant's interpretation of MiFID 2, together with the absence of any indication in the proposals for MiFID 1 or MiFID 2 that a change of meaning was intended.

95. The Claimants, not unreasonably, point instead to the change of wording and ask rhetorically why the wording changed if the meaning did not. Mr McClelland emphasises the importance of consumer protection in the policy underpinning MiFID 2, which followed the financial crash of 2008. That point, however, loses some of its force because the new wording had already appeared in MiFID 1 in 2004.

96. Mr McClelland nevertheless urges upon me a purposive reading of MiFID 2 and, for the purpose of investor protection, refers to recital (3):

> "In recent years more investors have become active in the financial markets and are offered an even more complex wide-ranging set of services and instruments. In view of these developments the legal framework of the Community should encompass the full range of investor-oriented activities. To this end, it is necessary to provide for the degree of harmonisation needed to offer investors a high level of protection."

97. I do not doubt that extending the scope of transferable securities would extend the scope of consumer/investor protection. It is disturbing that providers of financial products may be able to sidestep consumer protection by relying on spurious contract terms.

98. Nevertheless, in interpreting MiFID 2 I also have to be mindful of the fundamental EU principle of legal certainty. It would be both surprising and unsatisfactory if a security which stated on its face that it was not transferable was nevertheless defined as a transferable security. I am not persuaded that the inclusion of "bonds", without qualifying words, in Article 4.1(44)(b) can be interpreted as having that effect.

[2] Gloster Report, Appendix 5, paragraph 5.13(a).

99. The Claimants also rely on what they say are wider consequences of the Defendant's interpretation.

100. The first of these, they submit, is that the UK would have failed properly to implement the Capital Requirements Directive (Directive 2013/36/EU, "the CRD").

101. The CRD requires member states to regulate the activity of "taking deposits and other repayable funds" (CRD Annex 1, paragraph 1). Article 9 of the CRD requires member states to prohibit persons or undertakings other than credit institutions from taking deposits or other repayable funds from the public, save in "cases expressly covered by national or Union law, provided that those activities are subject to regulations and controls intended to protect depositors and investors". The scope of regulated activities under the RAO includes "accepting deposits" (RAO Article 5), but bonds are expressly excluded from that definition by RAO Article 9, read with Article 77. Mr McClelland argues that if bonds of the kind issued by LCF are not treated as "transferable securities" under MiFID 2 and therefore under Article 14 of the RAO, they fall into an unregulated lacuna, meaning that there has been (to that extent) a failure to implement the CRD.

102. Mr McClelland further argues that cases falling within the exclusion in Article 9 are also excluded from the compensation mandated by the Deposit Guarantee Schemes Directive (2014/49/EU) which applies to bonds other than those which are financial instruments regulated under MiFID 2. The latter are subject to the Investor Compensation Scheme Directive (97/9/EC). So if the LCF bonds are not transferable securities, Mr McClelland argues, the UK has "opened up a gap between investor and depositor compensation of a kind that the CJEU has been slow to conclude exists" (skeleton argument paragraph 86e).

103. In my judgment one answer is that, as Mr Handyside submits, the requirement in Article 9 of CRD for "regulations and controls" does not refer only to the regulatory regime under MiFID 2. The issue of the Bonds in the present case was subject to other regulatory requirements such as the regulation on financial promotions under section 21 of FSMA, the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (SI 2005/1529) and the rules in the FCA's Conduct of Business sourcebook ("COBS 4"). Meanwhile it appears to be common ground that MiFID 2 is not concerned with the authorisation of deposit-taking in general.

104. A more fundamental answer, however, is that if there is a lacuna in regulation or investor protection then it may require to be addressed as a matter of policy, but its existence or potential existence is not sufficient reason to read the words of Article 4.1(44)(b) contrary to their literal meaning, so that "transferable securities" encompass securities which are not transferable.

105. I therefore conclude (subject to Grounds 2 and 3) that the Bonds, which were in fact subject to express terms prohibiting their transfer, were for that reason not negotiable on the capital market and therefore were not "transferable securities". Ground 1 therefore fails.

Ground 2

106. By Ground 2, the Claimants contend in the alternative that the no-transfer clauses were ineffective in law, that the agreements for the Bonds should therefore be read and given effect without those clauses and therefore that the Bonds were in fact transferable and were, in law, “transferable securities”. As I have said, this Ground sub-divides into Ground 2A which applies to all of the Bonds, and the alternative Ground 2B which applies to the ISA Bonds.

Ground 2A

107. The starting point is section 62 of the Consumer Rights Act 2015 which provides, so far as is material:

> “(1) An unfair term of a consumer contract is not binding on the consumer.
>
> …
>
> (3) This does not prevent the consumer from relying on the term … if the consumer chooses to do so.
>
> (4) A term is unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer.
>
> (5) Whether a term is fair is to be determined—
>
> (a) taking into account the nature of the subject matter of the contract, and
>
> (b) by reference to all the circumstances existing when the term was agreed and to all of the other terms of the contract or of any other contract on which it depends.”

108. Section 63 further provides:

> “(1) Part 1 of Schedule 2 contains an indicative and non-exhaustive list of terms of consumer contracts that may be regarded as unfair for the purposes of this Part.
>
> (2) Part 1 of Schedule 2 is subject to Part 2 of that Schedule; but a term listed in Part 2 of that Schedule may nevertheless be assessed for fairness under section 62 unless section 64 or 73[3] applies to it.”

109. Section 64 provides:

[3] Section 73, which excludes terms reflecting mandatory statutory requirements from the assessment of fairness, is not material for present purposes.

> "(1) A term of a consumer contract may not be assessed for fairness under section 62 to the extent that—
>
> (a) it specifies the main subject matter of the contract, or
>
> (b) the assessment is of the appropriateness of the price payable under the contract by comparison with the goods, digital content or services supplied under it.
>
> (2) Subsection (1) excludes a term from an assessment under section 62 only if it is transparent and prominent.
>
> (3) A term is transparent for the purposes of this Part if it is expressed in plain and intelligible language and (in the case of a written term) is legible.
>
> (4) A term is prominent for the purposes of this section if it is brought to the consumer's attention in such a way that an average consumer would be aware of the term.
>
> (5) In subsection (4) "average consumer" means a consumer who is reasonably well-informed, observant and circumspect.
>
> (6) This section does not apply to a term of a contract listed in Part 1 of Schedule 2."

110. The Claimants argue that the non-transfer terms were unfair terms within the meaning of section 62 and therefore were not binding. They further argue that in the absence of binding non-transfer terms, the Bonds were transferable securities.

111. It is common ground that a "consumer contract" came into being between LCF and each of the Claimants. Save to that extent, the Defendant resists each element of Ground 2A.

112. In particular the Defendant asserts that even if the non-transfer terms were unfair and therefore were not binding, nevertheless the Bonds would not be transferable securities. I address this issue first, because of its potentially decisive effect on Ground 2.

113. Mr Handyside reminds me that a transferable security must be "negotiable on the capital market". His argument is that even if, by operation of CRA section 62(1), an unfair non-transfer provision is "not binding on the consumer", that does not mean that the provision is void *ab initio*. Therefore the non-transfer term would be binding on a third-party assignee of a bond and, *a fortiori*, on a third-party assignee who was not dealing as a consumer. There could therefore be no secondary market in the Bonds. The ability of the original bondholders, because they were consumers, to make a single transfer would not render the Bonds negotiable on the capital market.

114. Mr McClelland retorts that the effect of section 62 must be to prevent the non-transfer terms from having their unfair effect. If that means permitting unlimited onward transfers by third parties, that is the effect of the section. He refers to the decision of the CJEU in *NMBS v Kanyeba and others* [2020] 2 CMLR 6, where the Court said

that Article 6(1) of Directive 93/13/EC (which is implemented in the UK by section 62) means:

> "… that it is for the national court to establish all the consequences, arising under national law, of a finding that the term in question is unfair in order to ensure that the consumer is not bound by that term. In that regard, the Court has stated that, where the national court considers a contractual term to be unfair, it is required to disapply it in order that it may not produce binding effects with regard to the consumer, except if the consumer opposes that non-application (see, to that effect, judgments of 30 May 2013, *Asbeek Brusse and de Man Garabito*, C-488/11, EU:C:2013:341, paragraph 49 and the case-law cited, and of 26 March 2019, Abanca Corporación Bancaria and Bankia, C-70/17 and C-179/17, EU:C:2019:250, paragraph 52)."

115. It seems to me that *Kanyeba* does not bear the weight which the Claimants seek to place on it.

116. The facts of *Kanyeba* do not shed any light on the extent of this Court's powers in the present case. They were concerned with the separate question of whether an unfair term could be modified by a court, rather than disapplied.

117. The first of the two quoted propositions, that it is for the national court to "establish all the consequences", can be traced back to earlier decisions such as *Asturcom Telecomunicaciones SL v Nogueira* [2009] ECR I-9759. In each of these earlier cases, the issues were of a procedural nature, in particular whether corrective action could be taken to eliminate an imbalance between a supplier and a consumer even where the consumer had not taken legal action. The judgments do not contain any enlightening information about the meaning of the words "all the consequences".

118. The second proposition, that a national court must disapply an unfair term so that it may not produce binding effects, is based on the cited earlier case of *Asbeek Brusse.* There too, the point being made by the Court was of a procedural nature and was not about the extent of a national court's powers. It was that a national court which finds a term unfair of its own motion may decide the consequences of the finding without awaiting a request from the consumer to nullify the term.

119. I have concluded that an order disapplying the non-transfer provisions in the case of the Claimants would not turn the Bonds into securities which are "negotiable on the capital market" and therefore into "transferable securities" for regulatory purposes. That is for two reasons.

120. First, each of the Bonds would remain a bond constituted by a Bond Instrument which states that it cannot be transferred, although the effect of section 62 would be that that term could not be enforced against any of the Claimants. The security, as distinct from the contract by which each Claimant acquired it, would retain its original characteristics.

121. In my judgment that interpretation is supported by section 62(3), which enables consumers to rely on an unfair term if they so choose. This indicates that the term in question remains capable of having legal effects even if it cannot be enforced against a consumer.

122. So an original purchaser who was a consumer would be allowed to effect a transfer, if a purchaser could be found, but the survival of the non-transfer characteristic in the instrument itself would, in my judgment, be inconsistent with the existence of any genuine "capital market" on which the Bonds could be truly negotiable.

123. The second reason is that the Claimants, in my judgment, do not seek merely the disapplication of an unfair non-transfer provision so that they are free to transfer the Bonds. Instead, they are asking the Court in effect to turn unregulated securities into regulated securities.

124. My conclusion, on balance, is that this would go beyond the powers of the Court under section 62. The CJEU cases referred to above repeatedly emphasize that the purpose of corrective action by the court is to restore balance to the parties' transaction. But here, the true purpose would be to give the Claimants a regulatory remedy outside the contractual transaction.

125. Moreover, to permit the Court to change the regulatory status of the Bonds in this way would offend against legal certainty. It is not just that the Claimants would have a right to compensation from the Defendant, despite the express terms of the transaction having persuaded the Defendant otherwise. It seems that LCF would also have been (and other providers in a like situation could be) liable for a criminal offence by marketing products that turned out, thanks to a judicial assessment of a non-transfer term, to be transferable securities[4]. It would be too late to remedy other defects in regulatory compliance, such as capital requirements on investment firms that deal in transferable securities[5].

126. I have therefore concluded that this point provides a complete answer to Ground 2A.

127. In those circumstances I shall deal relatively briefly with the question of whether the non-transfer provisions were unfair, i.e. of whether, contrary to the requirement of good faith, they caused a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer.

128. The Claimants first point out that the non-transfer provisions are of two kinds found in the indicative list of "terms of consumer contracts that may be regarded as unfair" in Part 1 of Schedule 2 to the 2015 Act, namely:

> "A term which has the object or effect of inappropriately excluding or limiting the legal rights of the consumer in relation to the trader or another party in the event of total or partial non-performance or inadequate performance by the trader of any of the contractual obligations"

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[4] As the Defendant points out, offering transferable securities to the public without making available a FCA-approved prospectus would be an offence under FSMA section 85.

[5] See Article 15 of MiFID II and the Capital Requirements Regulation 575/2013/EU.

and

> "A term which has the object or effect of excluding or hindering the consumer's right to take legal action or exercise any other legal remedy" (emphasis added)."

129. Inclusion in this "grey list", without more, does not mean that a term is unfair. It seems to me that one or both of these descriptors could indeed be applied to the non-transfer provisions, and therefore they were required to be closely scrutinised for fairness. The Defendant argues that the non-transfer provisions do not limit the consumer's legal rights in the event of a failure of performance or hinder the consumer's right to exercise legal remedies <u>under the contract</u>. It seems to me, however, that Part 1 of Schedule 2 is expressed in deliberately broad terms, referring to rights "in relation to the trader or another party".

130. In published guidance on the 2015 Act, the Competition & Markets Authority also describes terms which restrict the right of "purchasers to transfer … to someone else what they bought" as being "open to scrutiny".

131. The leading case on the test of unfairness (then found, in like terms, in the Unfair Terms in Consumer Contracts Regulations 1999), interpreting and applying EU authority, is *Parking Eye Ltd v Beavis* [2015] UKSC 67, [2016] AC 1172. Lords Sumption and Neuberger, giving a judgment with which the other Justices concurred, stated the following propositions at [105]:

> "1) The test of 'significant imbalance' and 'good faith' in article 3 of the Directive (regulation 5(1) of the 1999 Regulations) 'merely defines in a general way the factors that render unfair a contractual term that has not been individually negotiated' (para 67). A significant element of judgment is left to the national court, to exercise in the light of the circumstances of each case.
>
> 2) The question whether there is a 'significant imbalance in the parties' rights' depends mainly on whether the consumer is being deprived of an advantage which he would enjoy under national law in the absence of the contractual provision (paras 68, 75). In other words, this element of the test is concerned with provisions derogating from the legal position of the consumer under national law.
>
> 3) However, a provision derogating from the legal position of the consumer under national law will not necessarily be treated as unfair. The imbalance must arise 'contrary to the requirements of good faith'. That will depend on 'whether the seller or supplier, dealing fairly and equitably with the consumer, could reasonably assume that the consumer would have agreed to such a term in individual contract negotiations' (para 69).

> 4) The national court is required by article 4 of the Directive (regulation 6(1) of the 1999 Regulations) to take account of, among other things, the nature of the goods or services supplied under the contract. This includes the significance, purpose and practical effect of the term in question, and whether it is 'appropriate for securing the attainment of the objectives pursued by it in the member state concerned and does not go beyond what is necessary to achieve them" (paras 71-74).'"

132. In my judgment, asking these questions leads to the conclusion that the non-transfer provisions were unfair.

133. Clearly the non-transfer provisions deprived purchasers of advantages which they would otherwise enjoy under domestic law because, first, the provisions locked them into the transaction when otherwise they could have sold their bonds, and second, the provisions deprived them of regulatory protections including the compensation scheme at issue in this case. LCF, by contrast, was in an entirely normal position for an issuer of a bond, having the benefit of the funds during the bond term and having the obligation to repay the debt on the due date. It does not seem to me that this comparison is affected in any way by describing the securities (as the Defendant proposes) as "mini-bonds" rather than as bonds.

134. The Defendant argues that the imbalance, consisting of the regulatory disadvantages to the consumer, was not "under the contract" as section 62(4) requires. However, it seems to me that locking the purchasers into the Bonds was itself an imbalance, not least where LCF reserved the right to make early repayment. The fact that the consequent detriment was or might be for reasons including reasons extraneous to the contract does not carry the case outside section 62(4).

135. I see no clear reason why any purchasers would have agreed to the non-transfer provisions in individual negotiations. Those provisions were of no value to the purchasers. Their only apparent purpose would have been to relieve LCF of regulatory obligations.

136. The apparent purpose and practical effect of the terms thereby support the proposition that the resulting imbalance was contrary to the requirement of good faith.

137. That proposition is also supported by a lack of transparency in this aspect of the transactions. Admittedly the non-transfer provisions were prominent and clearly stated, as was the lack of regulatory protection including the exclusion from the FSCS compensation scheme. However, there was no reference to, let alone any explanation of, the fact that it was the non-transferability of the Bonds which caused the lack of regulatory protection, or the apparent fact that the purpose of the former was to achieve the latter.

138. EU case law makes clear that omissions of this kind can deprive a contract of transparency for the purpose of its assessment under the Unfair Consumer Terms Directive (Directive 93/13/EEC) which the CRA implements. In *Matei v SC Volksbank România SA* EU:C:2015:127, in the context of credit agreements, the CJEU said at [74]:

> "[I]t is of fundamental importance, for the purpose of complying with the requirement of transparency, to determine whether the loan agreement sets out transparently the reasons for and the particularities of the mechanism for altering the interest rate and the relationship between that mechanism and the other terms relating to the lender's remuneration, so that the consumer can foresee, on the basis of clear, intelligible criteria, the economic consequences for him which derive from it."

139. And in *Ruxandra Paula Andriciuc v Banca Românească SA* ("Andriciuc") EU:C:2017:703 the CJEU said at [45]:

> "… the requirement that a contractual term must be drafted in plain intelligible language is to be understood as requiring also that the contract should set out transparently the specific functioning of the mechanism to which the relevant term relates and the relationship between that mechanism and that provided for by other contractual terms".

140. LCF in this case were in a much stronger bargaining position than any potential investor, and imposed the crucial terms without explaining either their reason or their practical significance. In those circumstances it is impossible to assume that any consumer would have agreed to them in any individual negotiation.

141. In my judgment the position is clear in respect of all of the Bonds, but it is even clearer in the case of the ISA bonds. The non-transfer provisions were sufficient to bar the Bonds from ISA status, because that status is reserved for "qualifying investments" as defined by regulation 8A of the ISA Regulations 1998. The relevant category for present purposes is that of a debenture which is a "transferable security": reg 8A(4)(a). That term is defined in reg 2 by reference to FSMA section 102A(3), which in turn cross-refers to the definition in MiFID 2.

142. There was a striking lack of transparency in the descriptions of those bonds by reference to ISA status, which in reality was unachievable because of the non-transfer provisions[6]. Any right to damages against LCF would be a poor substitute for the ISA eligibility which consumers believed that they were acquiring. It is obvious that reasonably well informed consumers would not have agreed to those terms in any individual negotiation concerning the ISA bonds.

143. In response to the Claimants' case under section 62, the Defendant submits that the non-transfer provisions legally could not be assessed for unfairness because they "specify the main subject matter of the contract": CRA section 64(1)(a). In my judgment, however, they do not. It is common ground that a term is within that "safe

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[6] The Defendant identifies a second reason why the Bonds were not ISA-eligible and would not have been so even without the non-transfer provisions, namely that the investments did not satisfy the further requirement of reg 8A(4)(b) of the ISA Regulations 1998 to be "facilitated by a person carrying on an activity of the kind specified in Article 25 of the Regulated Activities Order 2001 through an electronic system operated by that person". The Claimants rely on evidence to show that this assertion is incorrect. It is not necessary or appropriate for this Court to resolve that collateral question. As I explain in the body of this judgment, the non-transfer provisions were inconsistent with the professed ISA status of the Bonds and that could be expected to be of decisive importance for investors.

harbour" only if it "lays down the essential obligations of the contract and, as such characterise it" as opposed to being "ancillary to those that define the very essence of the contractual relationship": *Kásler v OTP Jelalogbank Zrt* (C-26/13) [2014] 2 All ER (Comm) 433 at [49-51]. In my judgment, transferability is clearly a secondary aspect of the contract in question. The essential obligations were payment of the subscription, accrual of interest and repayment upon maturity.

144. Even if the non-transfer provisions were otherwise within the "safe harbour", it is at least arguable that their lack of transparency would defeat reliance on section 64(1)(a) by virtue of section 64(2): see paragraphs 137-139 above.

145. Alternatively, section 64(6) prevents the Defendant from relying on section 64(1)(a) because the terms fall within the "grey list": see paragraphs 109 and 128-129 above.

146. For the reasons set out above, I conclude that the non-transfer provisions were unfair within the meaning of section 62, but that this finding does not mean that the Bonds were transferable securities.

147. The latter conclusion means that Ground 2A must fail.

Ground 2B

148. That conclusion also defeats Ground 2B, to the extent that it relies on section 62.

149. There is however an alternative strand of Ground 2B. For this purpose the Claimants rely on section 69(1) of the CRA 2015, which materially provides:

> "If a term in a consumer contract … could have different meanings, the meaning that is most favourable to the consumer is to prevail."

150. The Claimants rely on what their counsel describe as the "collision between the ISA-eligibility provisions and the no-transfer provisions" i.e. the fact that the no-transfer provisions are a bar to ISA eligibility. And if there is any doubt about whether ISA eligibility provisions are incorporated then, says Mr McClelland, it is resolved by section 50 of the CRA whose effect is to treat pre-contractual statements as terms. He argues that if both sets of provisions – ISA eligibility and non-transfer – are to be given meaning, then this clash must be resolved. The more favourable resolution, he suggests (and it is hard to see what if any other resolution is possible), is to read the non-transfer provisions as applying "save to the extent required for the Bonds to be negotiable, and hence ISA-eligible". So, the argument goes, the ISA Bonds would become transferable securities by this statutory modification.

151. In my judgment, however, Ground 2B does not get off the ground. That is because there is no term in the bond contracts which "could have different meanings". Instead, the issue is that the no-transfer provisions and the terms providing for ISA status contradict each other. I am not persuaded that this conflict, or the overall lack of transparency identified above, brings section 69 into play.

152. Therefore Ground 2B also must fail.

Ground 3

153. If Grounds 1 and 2 fail and the Bonds were not transferable securities, the Claimants rely on Ground 3 in the further alternative[7], contending that the non-transfer provisions in the subscription agreements (as opposed to the similar provisions in the Bonds themselves) were ineffective for the reasons given under Ground 2 above. The effect, they say, would be that LCF, by way of the subscription agreements, agreed to provide transferable bonds, and thereby engaged in the regulated activity of agreeing to deal in investments as principal.

154. Mr McClelland put his case in this way: "in the event that we were unable to convince you on a construction of the bond instrument that the no-transfer provisions should be disapplied in that instrument pursuant to the CRA, but we were able to persuade you that the provisions for non-transferability in the subscription agreements should be disapplied, the effect would be that the agreements were to provide bonds, and bonds being by default transferable, it would be an agreement to provide transferable bonds."

155. In argument, Mr McClelland emphasised that the brochures and the Information Memoranda, including the subscription agreements, do not contain any reference to the Bond Instruments. Therefore, he says, the subscription agreements are to be construed by reference only to their own contents and not to the contents of the Bond Instruments.

156. The key question is whether this distinction means that Ground 3 does not fail for the reasons that Ground 2 failed.

157. In my judgment, the reasoning at paragraphs 120-122 above applies to each subscription agreement as it applies to each of the Bonds themselves, even when the two are considered separately. The Claimants entered into agreements to buy Bonds which would not be transferable. The effect of CRA section 62 was that the non-transfer terms could not be enforced against the Claimants. Nevertheless those terms did not altogether disappear, and they would be effective against third parties (and certainly against non-consumer third parties). So even after the statutory modification the agreements were not, as Mr McClelland contends, agreements to buy bonds which were entirely free of non-transfer terms. Rather they were agreements to buy bonds with non-transfer terms which were modified as I have described. These were not agreements to buy bonds which were "negotiable on the capital market".

158. The reasoning at paragraphs 123-125 above is also applicable to Ground 3. Ingenious though the suggestion is of considering the subscription agreements separately from the Bonds themselves, the reality is that this is a device aimed at bringing unregulated instruments within the scope of regulation. If I am right that the Bonds were not and did not become transferable securities, then the agreements to subscribe were not agreements in respect of transferable securities.

159. Therefore Ground 3 also fails.

[7] After the hearing, the Claimants' solicitors also informed me that one of their clients is in a position to contend that LCF agreed to issue bonds to them during the relevant period although those bonds were never in fact issued because regulatory action supervened. The position of that client and perhaps other investors would therefore be affected by my decision on Ground 3, regardless of the outcome on Ground 2.

Conclusion

160. It goes without saying that the Claimants and their fellow investors deserve the greatest sympathy for the plight in which LCF left them. Nevertheless, despite the force, lucidity and skill with which their case was advanced before me, the claim must be dismissed.