THE ALL-PARTY PARLIAMENTARY GROUP ON FAIR BUSINESS BANKING

SUBMISSION TO THE SOLICITORS REGULATORY AUTHORITY

RE: HERBERT SMITH FREEHILLS LLP

The Lloyds Banking Group Reading Fraud

Undermining Confidence in the Legal Profession

Abbreviations/definitions

Unless otherwise indicated or contextually helpful, the following abbreviations/definitions are adopted (usually after first reference):

All Party Parliamentary Group on Fair Banking	APPG
Assurance review by Cranston of the Griggs Review	the Assurance Review
Bank of Scotland Plc	BOS
BOS Reading Branch Impaired Asset Unit	Reading IAU
Dame Linda Dobbs DBE	Dobbs
Freshfields Bruckhaus Deringer LLP	Freshfields
Griggs Review and compensation scheme for victims of the Reading IAU	the Griggs Review
Herbert Smith Freehills LLP	HSF
Halifax Bank of Scotland Plc	HBOS
Lloyds Banking Group Plc	LBG
(for convenience, 'LBG' may include references to parts of the merged bank)	
Professor Sir Ross Cranston KBE	Cranston
Professor Russel Griggs	Griggs
Project Lord Turnbull report	PLT report
Solicitors Regulation Authority	SRA
Thames Valley Police	TVP
TVP's investigation of the Reading IAU fraud	Operation Hornet

Introduction

1. The Lloyds Banking Group Plc (BOS) Reading branch Impaired Asset Unit fraud is one of the biggest frauds in English banking history. On some estimates the Reading IAU fraud caused

losses of around £1 billion. Only a fraction (about a quarter) was the subject of a successful prosecution in 2017.

2. In 2007 Paul and Nikki Turner wrote to Peter Cummings and Andy Hornby at HBOS explaining in some detail how, as customers of the bank, they believed that they were victims of a fraud perpetrated by the bank itself. Their experience is widely known and extensively published.

3. As will be seen, the circumstances of the Reading fraud were referred to internally by HBOS and LBG as "the Reading Incident".

4. On 14 October 2008 Mr Andrew Reade, a customer of Lloyds Bank, delivered a bulky document to Sir Victor Blank, then Chairman of the bank. The document identified an alleged fraud by Quayside Corporate Services Ltd and highlighted Quayside's arrangements with HBOS and a director of the Impaired Assets unit at HBOS's Reading branch, Lynden Scourfield. Lloyds was about to take over HBOS as a result of the financial crisis.

5. The Turners and Mr Reade received no response from HBOS or Lloyds. The Turners were made subject to no less than 22 applications by HBOS, and after merger by LBG, to the court for repossession of their home. The Turners consistently contended that they were victims of a bank fraud. Rather than investigate those allegations it appears that HBOS then LBG sought to silence the Turners.

6. Ms Sally Masterton, a chartered accountant and senior risk manager at HBOS (having been headhunted by the bank in 1998 to join the high-risk team) and then LBG, following merger in 2009, investigated the circumstances of the Reading IAU - including the Turners' circumstances. Ms Masterton assisted Thames Valley Police with its criminal investigation Operation Hornet. She subsequently provided TVP with a detailed 73-page statement in 2011. Later, in 2013, she wrote a report to LBG entitled 'Project Lord Turnbull'[1] (nothing to do with the former Cabinet Secretary). She was sacked by LBG in July 2014. Ms Masterton is on record as having been told by a senior manager in the bank, also being a witness in the TVP Operation Hornet, to shred documents. She declined to do so.

7. Ms Masterton wrote the PLT report, according to Anthony Stansfeld, TVP's police and crime commissioner, after complaining about her treatment by LBG executives and after she gave evidence to TVP in connection with Operation Hornet. Stansfeld dismissed the LBG's claims that the report had not been "requested or sanctioned by the group". Stansfeld is on record as saying that it had been commissioned by Sue Harris, then group audit director of LBG.[2]

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1 http://www.appgbanking.org.uk/wp-content/uploads/2018/06/draft-Project-Lord-Turnbull-Report-part-1.pdf
http://www.appgbanking.org.uk/wp-content/uploads/2018/06/draft-Project-Lord-Turnbull-Report-part-2.pdf

2 Financial Times 4 May 2018 Jonathan Ford.

8. On 30th July 2014 LBG, communicating through its solicitors HSF and/or in accordance with their advice/drafting, told public authorities and regulators that Ms Masterton's report was "undertaken by Ms Masterton of her own volition".

9. On 8th May 2014, Lloyds Group Counsel, Andrew Whittaker, stated in a letter to the FCA that having reviewed Ms Masterton's report in conjunction with "our legal advisers" (presumably HSF) that LBG was not persuaded that it would be an appropriate use of time and money to investigate "in the light of the outcome of the previous investigation and its evaluation of the credibility of Mrs Masterton.", clearly questioning her motives and competence (and mental balance).

10. TVP's investigation Operation Hornet reached its conclusion in February 2017 when Lynden Scourfield and others were sentenced to a total of 47 years' imprisonment for offences of fraud, corruption and dishonesty.

11. In May 2018, at the LBG AGM, Lord Blackwell, LBG's chairman, told shareholders that LBG 'stood by' a recent press release stating that Ms Masterton's report, that was confidential to LBG but had recently been leaked/published - shortly before it would have anyway been published and publication covered by Parliamentary privilege - had been written of her own initiative and not at the instance of LBG.

12. In November 2018 LBG, in a public statement as part of settlement of claims made against it by Ms Masterton, for the first time acknowledged that she had written the PLT report at the instance of LBG. The terms of settlement provided for confidentiality and an NDA.

13. From 2014 at the latest - and likely earlier than that - LBG retained as its legal advisers HSF (though it is understood that Freshfields acted for LBG in connection with Ms Masterton's dismissal from her employment in July 2014).

14. As Jonathan Ford wrote in the Financial Times on 12 March 2019, "Ms Masterton's story is central because of the light it sheds on one of the mysteries of the whole affair: precisely what LBG knew about Reading in the years before the convictions, and whether it took active steps to stop the truth coming out."[3]

15. In his sentencing remarks on 2 February 2017 at the criminal trial, His Honour Judge Beddoe said this:

> **"The case, an overview**: So much has been said and summarised about this case in court today that little is to be gained, before proceeding to individual sentences, by saying very much about it. It will have been obvious from the Crown's opening today that this case is not simply about a corrupt bank manager lending money he should not have

[3] https://www.ft.com/content/2fb12910-264d-11e9-b329-c7e6ceb5ffdf

> done to businessmen who went on to gamble with it. This case goes very, very much deeper than that. It primarily involves an utterly corrupt senior bank manager letting rapacious, greedy people get their hands on a vast amount of HBoS's money and their tentacles into the businesses of ordinary decent people … and letting them rip apart those businesses, without a thought for the lives and livelihoods of those whom their actions affected, in order to satisfy their voracious desire for money and the trappings and show of wealth.
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> The corruption, which profited mostly the first three defendants, subsisted for at least 4 years. It involved [Lynden Scourfield] engaging in as extensive an abuse of position of power and trust as can be imagined and was motivated on both sides of the corruption by the expectation of, and the very considerable realisation of, immense financial gain. That was at the cost of enormous losses to BoS of some £245 million [gross], but also and, in many respects worse, the destruction along the way of the livelihoods of a number of innocent hard-working people. Some of these connections were capable of rescue but what LS let happen through [David Mills and Michael Bancroft] predominantly ensured that they would not.
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> The harm for which you were individually and collectively are responsible can of course be quantified in cash terms, but cannot be so in human terms. Lives of investors, employers and employees have been prejudiced and in some instances ruined by your behaviour. People have not only lost money but in some instances their homes, their families, and their friends. Some who would have expected to be comfortable in retirement were left cheated, defeated and penniless. These are circumstances in which you [David Mills and Michael Bancroft] in particular show not a shred of remorse."

16. In short, the trial judge in 2017 expressed in succinct terms what the Turners and Mr Reade had communicated to HBOS and to LBG 10 some years' previously and what Ms Masterton had explained had happened, in detail, in the PLT report in 2013.

17. It is reasonable to infer that, but for the LBG's culture of denial, including the making of statements to public authorities that have since been shown to be demonstrably false, Lynden Scourfield and others would have been brought to justice significantly sooner with corresponding benefit and advantage to the victims.

18. LBG's knowledge is subject to an inquiry by the former High Court Judge, Dame Linda Dobbs DBE. The Dobbs inquiry is at LBG's instigation, it is a private, not a public, inquiry.

19. It is a source of surprise to the APPG (and to others) that that HSF were appointed by LBG to act as solicitors for the Dobbs inquiry.[4] It is understood that HSF have not in fact played an active part in the Dobbs inquiry. The inference is that that is to protect perceived independence.

[4] See report by Jonathan Ford Financial Times 21 September 2017.https://www.ft.com/content/56c4b870-9d26-11e7-8cd4-932067fbf946

20. There is no similar investigation, so far as is known, into what was known to LBG's legal advisers, in particular, known to HSF. This is a matter of concern to the APPG. Given the circumstances (below) there appears to be a strong argument in favour of such an inquiry. The SRA is able to undertake it.

21. HSF were also retained by LBG in a compensation review for victims of the Reading IAU fraud undertaken by Professor Russel Griggs (the Griggs Review). HSF were involved at every stage in establishing and undertaking the Griggs Review.

22. The Griggs Review was found by Professor Sir Ross Cranston, appointed to undertake an assurance review of it in response to widespread public and Parliamentary concern[5] about its processes and procedures, to be in important respects "unsatisfactory and unfair".[6] The Griggs Review was found so unsatisfactory by Cranston that an important part of compensation review concerning direct and consequential ('D&C') losses caused to customers by the fraud is now to be re-run under the chairmanship of another retired High Court Judge, Sir David Foskett. That comes at a cost, most obviously to the 191 victims of the Reading IAU fraud and claimants to LBG for compensation, whose lives, in many cases as Judge Beddoe observed, have been blighted by the fraud and, more particularly, LBG's response to it. These are real lives.

Preliminary observations and professional standards

23. The APPG, in referring the conduct of HSF to the SRA, is mindful that:

a. Solicitors individually are officers of the court and owe duties to the court that may be different from, and in tension with, duties that they owe to their clients professionally and as a matter of contract. Those duties may be called 'higher duties'. These duties outweigh duties that a solicitor owes to a client.

b. The central requirement of a solicitor in acting as an officer of the court, conscious that their higher duties to the court may be in tension with, and may indeed conflict with, the immediate interests of their client, is a fundamental requirement of *professional independence*. That requirement, and the higher duty owed to the court in the administration

[5] House of Commons, Debates, Westminster Hall, Hansard v.651, 18 December 2018. https://hansard.parliament.uk/Commons/2018-12-18/debates/51504BA8-AAA2-4085-8A3B-E20BC57A748A/HBOSReadingIndependentReview

[6] http://cranstonreview.com/Content/Documents/The%20Cranston%20Review_v2.pdf

of justice, is arguably a chief distinguishing characteristic of the solicitors' profession.

c. There is a vital public interest in the maintenance of *public confidence* in the legal profession, related to both (a) and (b) above, that is fundamental to the rule of law. If the public loses confidence in the legal profession the consequent harm will be incalculable.

24. The APPG is alive to the fact that unethical conduct by solicitors is not *per se* actionable (though many actionable wrongs are also plainly unethical) and carries no immediate risk, still less cost, either to a firm or to an individual, for those who engage in it. Ethical conduct (and, relatedly, personal integrity) accordingly, is particularly vulnerable to competing commercial imperatives. In contentious situations this imperative is to *successfully represent the client's interests*, whether in succeeding in litigation or in successfully maintaining a position that is subject to challenge – in short, winning. While short-term gain at the expense of ethical conduct and the maintenance of ethical values may be advantageous to a particular client, there is a collateral cost to society more generally, even - and perhaps especially- where the relevant conduct does not attract publicity (its consequences are nevertheless felt – as is the case, on the face of it, in the present circumstances). Ultimately, such conduct erodes public confidence.

25. While recognising that there are very powerful imperatives tending to erode or discount ethical conduct, the APPG takes the view that unethical conduct, where widespread or occurring over a long period of time, subverts public confidence in the legal profession and, consequently, in the legal system and the rule of law.

26. The APPG, for reasons outlined below, is of the view that HSF has exhibited, over time, conduct that:

a. Appears to exhibit a lack of professional independence.

b. Suggests that HSF has routinely subordinated higher duties it owed as officers of the court to the immediate short-term commercial objectives of its client.

c. Appears to be unethical (though as will appear, incompetence may provide an alternative explanation).

27. The APPG is alive to the obvious point that sometimes the boundary between what is legitimate action in the commercial interests of a client on the one hand, and unethical conduct and a failure in professional independence on the other, may be one that is unclear or may be blurred. The APPG is concerned that HSF's conduct exhibits a discernible pattern in consistently falling on the other side of that boundary.

28. The APPG in making these observations and representations to the SRA is conscious that the circumstances referred to below will in many, if not most, cases be subject to legal privilege, both legal professional privilege and sometimes litigation privilege.

29. The APPG does not consider that legal privilege should be an impediment to the SRA's evaluation of the merit of the APPG's complaints and its investigation of the circumstances and HSF's conduct.

30. The APPG is often only able to point to what happened, in any given circumstances and that these tend to exhibit an observable pattern, without (obviously) the APPG knowing the reason for a particular course of action – still less the motive for it. The reason for a particular course of action being followed by LBG will typically (in the circumstances to which we refer) have been that it took legal advice in doing so and followed and *acted upon* that advice.

31. The APPG takes the view, that is no more than common sense, that before a substantial institution such as LBG takes a step that will or may have significant legal consequences/repercussions – particularly in a regulatory context or in connection with public statements relating to legal disputes (Masterton below) - it will take legal advice before doing so. The advice of course is not known, but the nature of the advice may be inferred from subsequent action/conduct.

Professional incompetence as an available explanation

32. It is possible that advice given by HSF to LBG as its client *may not* have been given by HSF consciously or intentionally subordinating duties owed by it as officers of the court and abandoning proper exercise by it of independent judgment, but may, rather, be explained as the consequence of mere incompetence and poor judgment. As will be explained below, that binary choice applies, notably, to the Griggs Review that Professor Sir Ross Cranston condemned for being a scheme that was, in material respects, neither fair nor reasonable. It was so, either because it was intentionally so, that is to say by design, or alternatively because HSF *was simply incapable* of advising its client LBG as to how to structure and implement a fair and reasonable review and compensation scheme.

33. Further, the independence of Griggs was undermined. Again, that independence was lost by either inadvertence or by design.

34. Cranston described the scheme designed by LBG and HSF as an "unacceptable denial of responsibility" by LBG.[7] Denial of responsibility is a regularly recurring and consistent theme in LBG's conduct. It is implausible that LBG did not take extensive legal advice in adopting and steadfastly maintaining its denials of knowledge and responsibility, in particular in its engagement with statutory and regulatory bodies (below). It steadfastly maintained those

[7] Cranston 15.19, 15.20.

denials, in which it engaged HSF's active assistance (below) until well after the denials became untenable. LBG has now sought to deflect public scrutiny of its conduct to the inquiry being undertaken by Dame Linda Dobbs DBE (below). But it is not expected that Dame Linda's findings are to be made public.

35. The APPG takes the view that HSF's conduct is of a nature and pattern, over time, that suggests that its vigorous and committed engagement on behalf of LBG as its client has been both (i) at the cost of its professional independence and (ii) in the subordination of ethical values to its client's short-term commercial objectives.

36. The APPG considers that such conduct may carry a risk of a heavy price in terms of public confidence in the legal profession.

The 'litmus' test for ethical conduct – is this right?

37. Unethical conduct is deeply corrosive and damaging. While there is no direct remedy for unethical conduct, ultimately it undermines public confidence. From 2001 to 2003 The Honourable Justice Neville Owen, a distinguished judge of the Court of Appeal of Western Australia, headed a Royal Commission into the failure of the HIH insurance group that had collapsed with a loss of Australian $5.3 billion. At the time, it was the biggest corporate failure in Australian history. In April 2003 he produced his report. In his introductory remarks Justice Owen said this about corporate governance:

> "It would be a mistake, I believe, to dismiss the case of HIH as simply a corporate aberration. There was at least a semblance of standard governance mechanisms at work. By and large the people who were involved were not inherently bad or in some way set upon being part of a corporate disaster. HIH is a reminder, if one is needed, that a drastic fall from corporate grace can occur if those in charge lose their way."

38. Owen J. referred to the Cadbury Report and the Code of Best Practice, observing:

> "… the statements of principle have a broader application. The [Cadbury] report said:
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> "*The principles on which the Code is based are those of openness, integrity and accountability. They go together. Openness on the part of companies, within the limits set by their competitive position, is the basis for the confidence which needs to exist between business and all those who have a stake in its scenes. An open approach to the disclosure of information contributes to the efficient working of the market economy, prompts boards to take effective action and allows shareholders and others to scrutinise companies more thoroughly. Integrity means both straightforward dealing and completeness…*".

39. Transparency and the requirement for it in fair banking processes are a core campaigning concern of the APPG. It is all too often lacking.

40. The APPG takes the view that transparency requires, that where statements are made, for example to public authorities, that are later discovered to be false, that urgent steps be taken to correct the impression given by such falsity.

41. The reference to openness and the disclosure of information, and the failure to be open and a failure to give disclosure of information is a consistent theme in the conduct of LBG. It is impossible to infer that that such failures were often other than where legal advice had first been taken by LBG.

42. The Hon. Justice Owen, in his inquiry into the HIH failure, made some concluding remarks. He had by this time been working solidly on the inquiry for more than 18 months and made some personal observations. In words that have since become famous, he wrote:

> *"From time to time as I listened to the evidence about specific transactions or decisions, I found myself asking rhetorically: did anyone stand back and ask themselves the simple questions – is this right? This was by no means the first time I have been prone to similar musings. But I think the question gives rise to serious thoughts… Right and wrong are moral concepts, and morality does not exist in a vacuum. I think all those who participate in the direction and management of public companies, as well as their professional advisers, need to identify and examine what they regard as the basic moral underpinning of their system of values. They must then apply those tenets in the decision-making process. .... In an ideal world the protagonists would begin by asking: is this right? That would be the first question, rather than: how far can the prescriptive dictates be stretched? The end of the process must, of course, be in accord with the prescriptive dictates, but it will have been informed by a consideration of whether it is morally right. In corporate decision making, as elsewhere, we should at least aim for an ideal world. As I have said, 'corporate governance' is becoming something of a mantra. Unless care is taken, the word 'ethics' will follow suit."*

43. The APPG is concerned that, in the perceived imperative to successfully represent their client's interests, HSF appears frequently to have subordinated, to the point of exclusion, the question - "*is this right*"?

Ethical Failure – a failure to exercise independent judgment – or incompetence?

44. HSF were the firm of solicitors engaged by LBG in connection with the Griggs Review of the operation of the Reading IAU fraud. The appointment of Professor Griggs to chair the review was agreed between Andrew Bailey, then CEO of the Financial Conduct Authority and LBG.

45. LBG's CEO, Mr António Horta-Osório, by a letter dated 7 February 2017 addressed to Mr George Kerevan MP said that "LBG will agree with them [the FCA] the scope methodology and individual case outcomes of the review".

46. Contradicting Mr Horta-Osório, Mr Bailey, in a letter 9 days' later, stated that "[t]he FCA will not approve the scope and methodology for review and redress."

47. Accordingly, the scope and methodology of the review were left to LBG itself in consultation with Professor Griggs and with its legal advisers, HSF. This is important.

48. By a press release, Mr Horta-Osório stated that LBG undertook to put "right the wrongs that were committed at HBOS Reading" and to provide "fair swift and appropriate" compensation for the victims of the Reading IAU fraud.

49. While not directly germane to the APPG's immediate concerns, it is noticeable that:

a. Professor Griggs was appointed by LBG, albeit with some input from the FCA, that is to say, appointed by a party with a strong interest in the outcome of the review. That is at odds with the usual position of other fact-finding tribunals. The requirements of natural justice are generally satisfied by both actual and perceived independence of the parties.

b. It is understood that Professor Griggs' accounting, legal and insolvency professionals who assisted him in his review remained in many instances unidentified to the victims.

c. Professor Griggs was dependent upon information supplied to him by LBG.

d. The scope and methodology of the Griggs Review was determined without consultation with, or reference to, the victims. This is both unusual and unsatisfactory. Representations by the SME Alliance and the APPG, including in a series of letters in February and March 2017, were disregarded – a disregard later reflected in Cranston's report and in his criticisms.

e. No publicly available criteria were disclosed or published by LBG for eligibility for participation in the Griggs Review. This is both unusual and unsatisfactory.

f. The Griggs Review was established at a time when LBG's formal and publicly stated position was that it had known nothing of the criminality at the Reading IAU, a position that it maintained until after the conclusion of the criminal trial. This was a factual premise that *necessarily* informed the approach of both LBG and Griggs. It was wrong – and must be taken to have been known to be wrong by LBG, given what in November 2018 LBG revealed of the circumstances in which the PLT report was prepared (below). That is profoundly unsatisfactory.

g. The Griggs Review was established at a time when the PLT report prepared by Ms Sally Masterton was said by LBG to have been prepared by Ms Masterton at her

own instance and of her own volition and at a time when her reliability and balance had been undermined by LBG. This was later conceded to be false, and it was (eventually in November 2018) accepted by LBG that Ms Masterton had prepared the report on the instructions of LBG itself and that she had acted at all times with professional integrity. That is similarly unsatisfactory. Most victim's participation in the Griggs Review had concluded by then.

50. Each of the foregoing circumstances were separately unsatisfactory. Cumulatively, they contributed to rendering the Griggs Review both a procedural and substantive failure.

Cranston

51. In replying to the debate initiated by Kevin Hollinrake MP in the House of Commons on 18 December 2018[8] and the widespread public disquiet at the conduct and findings of the Griggs Review, the Economic Secretary to the Treasury announced that LBG had agreed with the FCA that it would commission a "post-completion review to quality assure the methodology and process" of the Griggs Review.

52. Professor Sir Ross Cranston was appointed to head the Assurance Review. Cranston delivered his review report on 10 December 2019.[9]

53. Cranston regretfully concluded that Professor Griggs had been conflicted and that he "*was placed [by LBG] in an impossible position*"[10] and that "*his appearance of independence was undermined by the way that the process was structured*".[11] The APPG takes the view that the structure of the review is very likely to have been agreed by LBG in consultation with HSF – if not in fact actually devised by HSF.

54. Griggs, in short, had been 'captured'. It appears that Professor Griggs himself failed to identify that he was placed in an impossible position. HSF were LBG's solicitors. HSF either recognised and appreciated that Professor Griggs' independence had been compromised – or else they were incapable of appreciating that fact and failed to notice it. This, despite conflicts of interest being well-understood by most lawyers and the independence of an inquiry or tribunal being of fundamental importance as a matter of natural justice. It appears to the APPG that if HSF failed to recognise that the chair of the review was compromised in his independence and placed in an impossible position, this is something that requires to be addressed more broadly in the legal profession, given its crucial importance and the obvious and substantial cost of failure – and the erosion of public confidence that accompanies high profile failures of this kind. If Professor Griggs' loss of independence and his being placed in

8 *Loc. cit.*
9 *Loc. cit.*
10 Cranston Introduction p 3 and paragraph 10.96.
11 *Ibid*.

an impossible position was inadvertent rather than intentional, it would seem that guidance given to the legal profession is insufficient.

55. More remarkably, Cranston concluded that, so far as direct and consequential (D&C) losses to business affected by the Reading fraud were concerned,

> "*this part of the Customer Review, both in structure and implementation, was neither fair not reasonable*."

Cranston was at pains to emphasise that: "*as a matter of analysis, therefore, on the Bank's approach, the Bank appears to have been the only victim of the fraud to have been caused financial loss*."

56. This was the result of the Customer Review *structure* that itself had the result that LBG Bank customers' D&C loss claims "*from the outset .. could not meet the standards that the bank had set for such claims, in part because the standards themselves had not been communicated to those claiming"*. This was a serious failure. The structure of the review, in that respect, was designed, whether intentionally or otherwise, so that victims could not meet the assessment criteria. There is a serious question in APPG's view about the role of HSF and the scope of its role in devising the scheme. This is a particular concern, but as will appear, it is part of the APPG's more general concern about HSF's role in a wider culture of denial of responsibility.

57. Cranston noted that, in some cases, where Professor Griggs was dissatisfied with LBG's approach to D&C claims, LBG responded by simply increasing allowed distress and inconvenience (D&I) payments. These, Cranston concluded, "*could not be logically justified*".[12] Not a single award was made by LBG for D&C losses. It is implausible that this outcome was not the product of legal analysis. That is to say, by attributing losses that were properly D&C claims/losses to distress and inconvenience (D&I) claims, the impression would be given and sustained that victims did not suffer commercial loss as a result of the Reading IAU fraud and that it was only Lloyds that suffered. This is both a legal analysis and a legal conclusion. It would be surprising if HSF were not very alive to both.

58. Cranston expressed his view that LBG's (and inferentially HSF's) approach <u>communicated</u> (to the victims and to the public) that the failure of every single company affected by the fraud was inevitable and not caused by the fraud, and that none of the customers' financial suffering had anything to do with the actions of the criminals. Such a communication was plainly intentional rather than the product of oversight by LBG and its lawyers HSF.

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[12] Cranston 15.58.

59. Accordingly, LBG by the Griggs Review, in Cranston's evaluation, "damagingly communicated" that *all the business failures and all of the suffering were of the customers' own making*.[13] Cranston concluded that:

> *"[t]his is an unacceptable denial of responsibility. It undermined the sincerity of the Bank's apologies for the IAR fraud*".[14]

60. He concluded that LBG's assessment of compensation was "flawed".

61. Both Professor Griggs' methodology and his conclusions could be said nicely to fit with the position that LBG had adopted when in receipt of complaints from Mr Reade, the Turners and many others. Further Cranston found that "*because the Bank never properly explained its methodology or its findings, customers were not given information to understand why they were (and were not) being compensated*". That is a very serious failing.

62. Cranston's evaluation of the Griggs Review has resulted in the requirement to re-run an important aspect of the compensation review so far as both direct and consequential losses are concerned. This will commence over 3 years' after the Griggs Review was created with the stated aim of delivering "swift" redress.

63. That the LBG Griggs Review is discredited is self-evident. Nevertheless, there remains in the APPG's view an important question, that while outside Cranston's remit, requires to be addressed, bearing in mind the public interest in upholding confidence in the legal profession and the importance of ethical conduct of solicitors in maintaining this. That question is

> *Why was the Griggs' Review both in structure and implementation neither reasonable nor fair so as to present LBG as the only victim of the Reading IAU fraud – representing an "unacceptable denial of responsibility" by LBG?*

64. As a matter of logic there are only two available explanations for Cranston's conclusion that the direct and consequential losses, both in structure and implementation were "neither fair nor reasonable" with the result that "*LBG appears to have been the only victim of the fraud to have been caused financial loss*", namely:

    a. The unreasonableness and unfairness were intentional in the structure – that is to say, deliberate and designed.

    b. The unreasonableness and unfairness were not intended but rather the product of some series of failures or omissions to provide a structure and implement it in a

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13 Cranston 15.20.

14 Cranston 15.19, 15.20.

way that was both fair and reasonable (that is to say, by incompetence rather than by intention).

65. It will be immediately apparent that there is no obviously available 'third way'.

66. It will also be noticed by the SRA that Cranston concluded that Professor Griggs' independence was compromised. As noted above, that is something that was either the product of some oversight, and unintended, or else it was intentional and 'engineered'.

67. HSF acted for LBG throughout this process.

68. The APPG is of the view that it is likely that HSF was heavily engaged in not only structuring the Griggs' review but also in implementing it.

69. There is in the APPG's view a strong public interest in the SRA being assured that, so far as the Griggs' Review was neither fair nor reasonable that:

(1) *HSF was not responsible for the unreasonableness and unfairness identified by Cranston – in either structure or implementation.*

(2) *So far as HSF was responsible for such unreasonableness and unfairness, either in structure (including the decision as to what information was provided to the bank's customers/victims and in devising the relevant tests applied by Professor Griggs in his evaluation of their claims) or implementation, the cause was incompetence of HSF and inadvertence rather than intentional unfairness and unreasonableness.*

(3) *HSF at no point ceased to maintain proper professional independence so that it aligned its own interests and actions with those of LBG as its client in presenting to the public the misleading conclusion that LBG appears to have been the only victim of the fraud to have been caused financial loss that represented an unacceptable denial of liability by LBG and communicated that all the business failures and all of the suffering were of the customers' own making.*

70. Further, the last point (*viz* the apparent conclusion from the compensation paid under the Griggs Review, that all the business failures and all of the suffering were of the customers' own making) would appear to be an intended, designed, outcome of, and inference to be drawn from, the Griggs Review.

71. In respect of the latter concern, we refer to HSF's involvement in what might be termed a 'culture of denial' by LBG further below.

A culture of denial

72. The FCA on 20 June 2019 by Final Notice of that date, imposed a discounted fine of £45,500,000 on the Bank of Scotland Plc.

73. The fine was imposed for BOS during the (limited) period of 3 May 2007 and 16 January 2009.

74. By 3 May 2007 BOS had identified suspicious conduct, including suspicion of fraud, at its Reading IAU. By Principle 11 it is a fundamental obligation of a regulated firm to deal with its regulators in an open and cooperative way. Specifically SUP 15.3.17R requires a regulated firm to notify the FCA immediately if it becomes aware that an employee may have committed a significant fraud against it. The FCA concluded that BOS "failed to be open and cooperative and did not disclose appropriately information when providing … communications" which were thus misleading. On three occasions in 2007 BOS informed the Authority that it had found no evidence of fraud. In fact BOS had identified suspicious conduct suggesting an inappropriate and potentially corrupt relationship concerning, in particular, one of its managers, Mr Lyndon Scourfield.

75. Despite being contacted by two police forces in 2008 BOS did not review its decision not to further investigate Mr Scourfield. BOS did not inform its regulator that it had been contacted by two police forces. LBG continued the culture of denial after merger of the group in LBG in January 2009 which is the subject of a further, ongoing FCA enquiry.

76. As is now well-known, after an investigation by TVP that began in 2010, in January 2017 6 individuals were convicted of offences of corruption, fraudulent trading and money laundering offences.

77. LBG had consistently denied that it was aware of any criminality and, according to the Evening Standard 5 July 2018, continued to deny it had been even after the convictions.

78. Of critical importance and relevance to LBG's denial of knowledge is a report known as the PLT report written by Ms Sally Masterton when employed by LBG as a Senior Manager in Credit Risk Oversight, Risk Division, Regulation and Governance Section.

79. The PLT report, as a matter of fact, was written by Ms Masterton at the Request in July 2013 of Ms Sue Harris, the Group Audit Director of LBG.

80. Ms Masterton's conclusion was that the conduct of the Reading IAU team was known of by BOS well before 2006. She stated that when Tom Angus became head of High Risk and Impaired Assets in 2006 at HBOS he became aware of the irregularities and that the Reading conduct, by no later than January 2007, was referred to within the bank as "the Reading Incident" (PLT report paragraph 21).

81. The PLT report at p 121 includes reference to a note from Mr Rory McAlpine in May 2009, at the time a senior partner in the firm Denton Wilde Sapte LLP (now called Dentons UKMEA LLP), then engaged as LBG's solicitors, that refers to "*the Reading Incident*", a parliamentary campaign (that was expected to 'fizzle out') and to the Turners as individuals affected by 'the Reading Incident'. It would be a surprise if these circumstances were known to Denton Wilde Sapte, but not known subsequently to HSF. Accordingly, what was known to HSF about the 'Reading Incident', and when, appear to the APPG to be very important questions.

82. At the time the PLT report was compiled, it was shown to the PRA and to the FCA and to TVP. It was not shown to the then Chairman of LBG nor to the bank non-executive directors. A copy was also provided to the Crown Prosecution Service.

83. The APPG does not know with any certainty, at what point HSF became involved in LBG's consideration of and response to the Reading IAU fraud/the 'Reading Incident'. What is clear beyond doubt, is that on 30 July 2014, Jenny Stainsby a partner in HSF, now global head of HSF's contentious financial services practice, wrote to Mr Stephen Rowland in the Specialist Fraud Division of the Crown Prosecution Service. In her letter Ms Stainsby stated:

> *"Operation Hornet"*
>
> *We are aware that you have been provided with a copy of a draft report produced by Sally Masterton, entitled, "Project Lord Turnbull".*
>
> *Lloyds Banking Group (LBG) does not consider it appropriate to comment generally on the accuracy or otherwise of any statements or assertions made, or conclusions drawn, in Ms Masterton's draft report. However, to the extent that it may suggest otherwise, LBG feels it ought to point out that the draft report was not commissioned by LBG. Rather, it was undertaken by Ms Masterton of her own volition*…."

84. That statement is now admitted by LBG to have been untrue.

85. Ms Masterton in July 2014 was dismissed from her employment with LBG. It is understood that her dismissal was closely connected with (i) her authorship of the PLT report and (ii) her communications with TVP. Prior to her dismissal TVP had highlighted Ms Masterton's particular importance to their ongoing investigation.

86. Ms Masterton issued proceedings against LBG alleging unfair dismissal. Her claims were settled on terms that included confidentiality and an NDA. Freshfields acted for LBG in the employment tribunal proceedings.

87. On 28 May 2018, at the LBG AGM, LBG's chairman Lord Blackwell publicly stated that LBG stood by a press statement it had made the previous week in which LBG publicly stated that

it had not commissioned Ms Masterton to write the PLT report. It is virtually certain, given that the prosecution case at the criminal trial in 2017 had largely followed the PLT report narrative of what happened, that, by May 2018, LBG with its legal advisers had very carefully considered the position in relation to the PLT report. That this is so is supported not least by the fact that the group's chairman was briefed on the position so as to be able to immediately respond to a question from a shareholder (Noel Edmonds) that expressly asked whether or not Ms Masterton's report was commissioned by the bank.

88. Ms Masterton first contacted Mr Andrew Bailey on 8 June 2018. She had told the APPG that LBG had written to the FCA in disparaging terms about her, "cynically intending to undermine my credibility and minimise the impact of the [PLT] report".

89. Ms Masterton has stated that a senior official in the FCA, Bill Sillett, met with David Poole and special investigator Mick Murphy (TVP) in around July 2014. Ms Masterton has stated that:

> "... *MM and David Poole went to Bill Sillett at the FCA. He pooh poohed it and said it was nothing to do with their investigation. X had already tried to whistle blow to Sillett (I don't have a date) and he had accepted the bank's explanation that she was mentally unstable and in any event her report was not reliable*."

90. The APPG understands the communication to the FCA by LBG in connection with the PLT report was along lines materially similar to HSF's communication with the Specialist Fraud Division of the Crown Prosecution Service.

91. Ms Masterton had commented that LBG had declined to investigate, "falsely asserting that all matters were already the subject of investigation by other (regulatory or criminal enforcement) authorities". Ms Masterton complained that LBG had "issued demonstrably inaccurate press statements to the effect that they had not commissioned or sanctioned the report".

92. Mr Bailey is understood to have encouraged LBG to come to a financial settlement with Ms Masterton. It is not known, but it is likely that HSF advised LBG upon the terms of settlement, including the terms of an NDA.

93. On 18th July 2018 Jonathan Ford in the Financial Times reported that LBG was reviewing Sally Masterton's case and considering whether the bank owed her an apology, he wrote:

> "… Norman Blackwell, is behind the initiative after he concluded the case was damaging the bank's reputation, … The board has delegated the task to another non-executive, Alan Dickinson, a former executive at Royal Bank of Scotland. Lloyds has come under pressure to explain its treatment of Sally Masterton, a former employee

> in the bank's high-risk division, who left in unexplained circumstances in 2014 after authoring the so-called "Project Lord Turnbull" report. … Mr Dickinson is understood to be reviewing whether she was fairly treated and whether the bank owes her an apology. The bank confirmed that it was in "private dialogue with the author of the Project Lord Turnbull report who we believe has acted with the best of intentions". It is the first time Lloyds has commented publicly on Ms Masterton's motivations. Previously, it has confined itself to observing that the report was not commissioned by the bank and contained unsubstantiated allegations."

94. Subsequently, in 2018, Ms Masterton commenced new proceedings against LBG. These also were settled on terms that included an NDA.

95. Following settlement of Ms Masterton's 2018 claims, LBG issued a press release in the following terms:

> "*Lloyds Banking Group very much regrets and apologises for the distress and inconvenience caused to Mrs Masterton following the publication of the "Project Lord Turnbull report" earlier this year, which named her as the author. Both parties can confirm they have agreed a financial settlement by way of compensation.*
> *The Group recognises that Mrs Masterton, who was a senior risk officer in the Group, acted with integrity and in good faith at all times in assisting the Thames Valley Police investigation and in raising her concerns with the Group. We confirm that Mrs Masterton's concerns were documented following a request from the Group that she set out her concerns in writing.*
> *The Project Lord Turnbull report was provided to the regulator and the police in 2014. It has also been provided to Dame Linda Dobbs, a retired High Court judge appointed by the Board of Lloyds Banking Group to consider whether the issues regarding HBOS Reading were investigated and appropriately reported to the authorities at the time by Lloyds Banking Group, following its acquisition of HBOS in 2009.*
>
> *We remain grateful for Mrs Masterton's continued and voluntary assistance to the Dame Linda Dobbs' independent review. The concerns Mrs Masterton raised with the Group, culminating in the Project Lord Turnbull report, and the Group's handling of those concerns, are important matters which Dame Linda will be considering.*
> *Mrs Masterton agrees with us that Dame Linda Dobbs' review is the appropriate forum for considering matters in relation to the "Project Lord Turnbull report", together with any investigation or enquiry by the FCA."*

96. It is implausible that LBG did not take external legal advice on the terms of that press release.

97. The importance of the foregoing is that it is obvious from the press release that the letter written by Ms Stainsby on behalf of LBG on 30 July 2014 to the CPS and by LBG to the FCA included a falsehood. That is to say, at the time, LBG knew and must be taken to have known that the PLT report was written, not of Ms Masterton's own volition, but at the instance of LBG itself.

98. It is not known, but the APPG considers it important to know, particularly in the light of the concerns that are expressed at the end of the previous section, whether HSF, following LBG's acknowledgement of the falsity of the position as stated by HSF on behalf of their client to the CPS in July 2014, *took steps to correct the statements made respectively to the CPS and (it is understood) to the FCA and to apologise for having made the statements?*

99. The APPG consider the foregoing to be important aspects of the requirement for transparency and that communications between law firms and statutory regulators are open and candid and factually correct.

100. It may well be that HSF will disavow any knowledge itself of the circumstances in which the PLT report was created.

101. It is to be expected that, when a well-known firm of solicitors that trades on the reputation that HSF seeks to project is seriously misled by its client and actively participates in the misleading of public authorities, whose responsibility includes protecting the public, it must immediately take all necessary steps, once it acquires knowledge of the true position, to correct the false and misleading impression that it previously conveyed to a public authority. One would also ordinarily expect that a firm, placed in the position that HSF had been by LBG, that is to say, caused to mislead public authorities at the instance of its client, would thereafter have urgent and serious discussions with its client. Any such discussions will almost certainly be a matter of record because the relevant conduct will foreseeably jeopardise/put at risk the entire solicitor-client relationship. No doubt inferences might be drawn from the absence of such a record.

102. In the APPG's view it would be surprising if certain consequences did not flow/professional obligations did not arise from HSF making false statements on behalf its client to a public authority after that fact comes to its attention. What those specific obligations are, in the particular circumstances, the APPG considers to be a matter for the SRA. One concern, that is immediately apparent, is that (if knowledge is disavowed) HSF's ability to provide to its client objective advice was itself undermined/compromised by LBG's misleading statement, for example, to the CPS. Had HSF known (and communicated) the true position in 2014, events not only may well have taken a rather different course, they almost certainly would have done so. It is arguable that Professor Griggs was not the only party to have been compromised in the Griggs Review.

103. Further, it is apparent that LBG engaged in a pattern of behaviour that can fairly be termed a denial of responsibility.

104. The letter from HSF dated 30 July 2014, in circumstances where Ms Masterton's employment had been terminated shortly before the letter was written which may now be seen to have been miselading, is entirely consistent with LBG's policy of denialism and a part of it.

105. It is particularly concerning to the APPG that LBG in the Griggs Review was to continue to engage in what Cranston termed an "unacceptable denial of responsibility". As with LBG's disavowal of the PLT report, the denial of responsibility of LBG under the Griggs Review was facilitated, on the face of it, by HSF.

106. There is a public interest in it being established, to the SRA's satisfaction, that HSF in acting as LBG's advisers maintained proper professional independence of judgment and conscious of the higher duties owed as officers of the court. Its role in both the 14 July 2014 letter and as advisers to LBG in connection with the seriously flawed Griggs Review is concerning.

The use of NDAs

107. In my letter dated 29 January 2020, the APPG expressed to the SRA concern about the appropriateness of certain terms that the Treasury Select Committee had considered in connection with NDAs provided in the Griggs Review. This issue continues to be a matter of concern and is subject to further consideration by the APPG. The APPG will make further comment in connection with the use of NDA's in connection with the LBG Reading matter in due course.

Assurances sought

108. Drawing together the foregoing strands, the APPG would welcome assurances from the SRA that it has considered the matters set out above and that:

(1) It is satisfied that HSF's knowledge of the 'Reading Incident' was not such as at any time to compromise its ability to exercise independent judgment.

(2) It is satisfied that HSF was not responsible for the unreasonableness and unfairness identified by Cranston – in either structure or implementation - of the Griggs Review.

(3) It is satisfied that, so far as HSF was responsible for unreasonableness and unfairness in the Griggs Review, in structure (including the decision as to what information was provided to the bank's customers/victims and in devising the relevant tests applied by Professor Griggs in his evaluation of their claims) or in its implementation, the cause was incompetence of HSF and inadvertence rather than intentional/designed unfairness and unreasonableness.

(4) It is satisfied that HSF at no point ceased to maintain proper professional independence so that it aligned its own interests and actions with those of its client so as to subordinate to those interests its higher duties and independence of judgment owed as solicitors and officers of the court.

This, in particular, in presenting to the victims and public under the Griggs Review the misleading impression that LBG was the only victim of the fraud to have been caused financial loss, that all the business failures and all of the suffering were of LBG's customers' own making and the related 'unacceptable' denial of liability by LBG. That is to say, those conclusions were neither intended nor designed conclusions or so far as they were, HSF had no part in designing or implementing them.

(5) It is satisfied that HSF has taken proper steps to correct statements of fact made by it on behalf of LBG as its client in or about 2014 to statutory bodies/authorities that Ms Masterton had prepared the PLT report without instructions from LBG, but rather of her own volition and at her own initiative, statements now known to have been false. It would also seem appropriate for the SRA to be satisfied that at the time those statements were made, given their importance, HSF was reasonably satisfied that the statements made were true.

(6) So far as HSF were unable to appreciate that Professor Griggs had been placed in an impossible position and that his appearance of independence had been compromised, and that this had happened by oversight rather than design, the SRA will take such steps as it is able to in ensuring appropriate relevant guidance is provided by the Law Society to the solicitors' profession.