IN THE UPPER TRIBUNAL **UT-2026-000048**

TAX AND CHANCERY CHAMBER

BETWEEN:

VOLKSWAGEN FINANCIAL SERVICES (UK) LIMITED

Applicant

and

THE FINANCIAL CONDUCT AUTHORITY

Respondent

APPLICANT'S REPLY

A. INTRODUCTION

1. This Reply is served pursuant to paragraph 10(a) of the Tribunal's Order dated 1 July 2026. It responds to the FCA's Grounds of Response served on 6 July 2026 pursuant to paragraph 8(a) of the Order ("the FCA Grounds").

2. Unless otherwise stated, in this Reply VWFS adopts the defined terms used in its Grounds of Review dated 27 April 2026. It also adopts, as appropriate, some of the additional defined terms used in the FCA Grounds.

3. VWFS responds in this Reply to what it understands to be the principal grounds on which the FCA defends the Applications. VWFS does not, however, respond to every single point made by the FCA in the lengthy FCA Grounds, much of which consists of arguments and submissions more suited to a skeleton argument than a statement of case. VWFS's submissions in support of its Application will, in the usual way, be set out in its skeleton argument for the rolled-up hearing.

B. OVERARCHING POINTS

4. Before dealing with the FCA's response to the four grounds on which VWFS's Application is made, it is convenient to address some overarching points which pervade the FCA's approach to the Applications. These mostly concern the FCA's attempt to insulate the Schemes from challenge by the repeated invocation of the mantra of "regulatory judgement"[1] as some kind of impregnable shield against the Applications. The FCA's approach in this respect is based on a fundamental misunderstanding of both (i) its power (and, importantly, the limitations on its power) to make rules establishing a CRS under FSMA; and (ii) the role of the Tribunal under s.404D when ruling on a challenge to a CRS such as the Application made by VWFS in this case.

5. First, the FCA's power to make rules to establish a CRS is not simply an exercise of discretion whereby the FCA can design a scheme as it sees fit in order to achieve its policy objectives. While the decision to establish a CRS in the first place may (provided the criteria in s.404(1) are satisfied)[2] be regarded as a policy decision, the rules which govern the scheme must then comply with the detailed and prescriptive requirements set out in the legislation, in particular ss.404 and 404A. The FCA's room for manoeuvre in designing a CRS is therefore limited, and in certain key respects severely limited, by these requirements.

6. Second, the reason for the prescriptive requirements set out in FSMA is that the purpose of a CRS is to enable, where this is possible, the resolution of a potentially large number of similar private-law consumer claims without consumers needing to have recourse to the courts. This is why the FCA is not permitted to include in a

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1 A phrase used 26 times in the FCA Grounds, and 20 times across its three witness statements.

2 The FCA argues that it has "discretion" to identify the failures referred to in s.404(1)(a) and to determine whether they would give rise to a remedy or relief: FCA Grounds, [86.1]. Whilst under s.404(1) the FCA must come to its own view as to whether there have been failures to comply with applicable requirements, and whether consumers have suffered loss or damage that would be remediable in legal proceedings (and therefore the FCA must take a view on what the relevant law is in relation to these issues), it has no discretion to determine: (1) the applicable requirements; (2) what amounts to a failure to comply with such requirements; or (3) whether loss or damage would be remediable in legal proceedings, all of which are matters of law. In any event, the fact that the FCA must come to its own view as to the criteria in s.404(1) does not remove or alter the restrictions on its rule-making power. The FCA is therefore wrong to state that the "breadth" of the "discretion" it has in relation to the criteria in s.404(1) "must flow through into the FCA's rule-making powers" on the same issues. The FCA makes an erroneous statement to similar effect in FCA Grounds, [117].

CRS certain matters that would not be relevant if the consumers' claims were litigated in court instead of being resolved through the CRS.[3]

7. Third, the restriction on the FCA's ability to include certain matters in a CRS is expressed in the legislation in absolute and unqualified terms. Thus, for example, a CRS may include rules setting out examples of things done (or omitted to be done) "that are to be regarded as constituting a failure to comply with a requirement".[4] But those rules may only include examples "that have been, or would be, held by a court or tribunal to constitute a failure to comply with a requirement".[5] Whether an example would be held by a court to constitute a failure to comply with a requirement is a question of law to which there is only one right answer.

8. Fourth, it is apparent that the FCA has fundamentally misunderstood this important limitation on its powers. In particular, it has attempted to add a gloss to the safeguards provided in s.404A(2)-(3) by asserting that it is able to include in a CRS examples which are merely "capable of being found by a court" to constitute a relevant failure.[6] That is irreconcilable with the clear language of the legislation. Not only that, but the FCA has also purported to arrogate to itself the right to exercise its supposed "regulatory judgement" to "prescribe circumstances capable of being found to constitute a failure"[7] and to endow itself with "a predictive or speculative discretion to identify or conjecture what a court 'would' do".[8] This is all entirely misconceived. The question of what a court would do is not a question calling for the exercise of "regulatory judgement", "predictive or speculative discretion", or "conjecture". While the FCA must of course make an assessment of what a court would do in the relevant respects when making the rules, if its assessment is challenged, the question then for the Tribunal is the binary one as to whether the FCA's view was correct.[9] This is not an issue on which the FCA can

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3 FSMA, s.404A(1)(b) and (c), read with s.404A(2) and (3).

4 FSMA, s.404A(1)(b). In this case, the non-disclosure of each of the "relevant arrangements" referred to in the Schemes is an "example" falling within this provision.

5 FSMA, s.404A(2).

6 FCA Grounds, [46].

7 FCA Grounds, [47].

8 FCA Grounds, [117]. See also [86.2], where the FCA similarly asserts that it has "a predictive discretion whereby the FCA may, in the exercise of its regulatory judgement, extrapolate from established legal principles and indications provided in relevant authorities in making the rules".

9 This is explicitly and rightly acknowledged by the FCA in CONRED 1.7.6G.

hide behind "regulatory judgement" or "discretion" and assert that its assessment was not irrational. That is not the test.

9. Fifth, the points made above explain why the Tribunal is expressly empowered to decide for itself whether, in certain key respects, a CRS as designed by the FCA correctly reflects the approach that a court would take in claims of the kind falling within the scope of the scheme.[10] Importantly, the role of the Tribunal in relation to these matters (sometimes referred to for convenience, although not in FSMA itself, as its "primary jurisdiction") is to decide for itself what the right answer is. It is not required (or permitted) to make that assessment with a predisposition to favour the FCA's opinion: it is required (in the case of the "failure to comply with a requirement" limb) simply to "determine whether the example constitutes a failure to comply with the requirement in question".[11] One of the themes running through the FCA Grounds is an attempt to marginalise the importance of the Tribunal's jurisdiction in these respects.[12] This is misguided for the reasons given above.

10. Sixth, the FCA has allowed itself to fall into error in the way it has sought to force the square peg of the "unfair relationships" provisions of the CCA into the round hole of the CRS regime under FSMA. This is most obvious in the way in which the Schemes deal, or rather fail to deal, with the issues of causation of loss and redress. In particular, the FCA has wrongly sought to rely, in its design of the Schemes and its defence of the Applications, on the fact that courts dealing with claims under s.140B of the CCA are not formally constrained by the conventional principles of causation, loss and damage that would be applicable in a claim for damages for breach of contract or in tort. The problem with the FCA's approach, however, is that it has not been granted the same freedoms, when establishing a CRS, as has been afforded to the courts under the CCA. On the contrary, the FCA is only permitted by FSMA to establish a CRS whose purpose is to compensate

[10] FSMA, s.404D(6)-(7).

[11] FSMA, s.404D(6). The equivalent provision for the issue of causation of loss is s.404D(7).

[12] See, e.g., FCA Grounds at [51], where the Tribunal's jurisdiction under s.404D(6)-(7) is wrongly described as "carefully and unsurprisingly limited". The FCA also erects a straw-man argument at [53], where it says that s.404D(6)-(7) "does not create for [the Tribunal] a 'merits' role in the sense of being entitled to substitute some different example or matter for that contained in the Scheme". However, no one has suggested that the Tribunal has the power to re-write the Schemes in this way: the only remedy at its disposal is to quash them, including on the grounds identified in s.404D(6)-(7).

consumers for loss or damage that can be determined (not presumed) to have been caused by a relevant failure by a firm: see in particular ss.404(1)(b), 404(6) and 404A(1)(c)(ii). The FCA has attempted to deal with this difficulty by asserting that, where a CRS is established in the context of "unfair relationships" within the meaning of the CCA, the FSMA requirements concerning causation of loss can be somehow "attenuated".[13] There is, however, simply no basis for this in the legislation.

11. Seventh, the FCA dismisses VWFS's distinct arguments in relation to A1P1 (VWFS's Grounds at [52.4(3)], [67.3] and [88.6]), principally on the bases that it is said that the grounds are "unparticularised" and that "the inclusion of A1P1 adds nothing" (FCA Grounds at [254]). That is obviously wrong. For each of Grounds 2, 3 and 4, VWFS has expressly pleaded that, insofar as judicial review principles apply, the FCA has acted (i) irrationally and (ii) in a manner incompatible with A1P1. The Tribunal's standard of review for A1P1 is materially different than for rationality. As the Supreme Court emphasised in *Shvidler v SSFCDA* [2026] AC 607, in the context of an A1P1 challenge, "the question whether an act is incompatible with a Convention right is a question of substance for the court itself to decide; the court's function is not the conventional one in public law of reviewing the process by which a public authority reached its decision" (at [120]; see further [120]-[125]). That is relevant in circumstances where, as addressed above, the FCA repeatedly emphasises that the Tribunal should undertake a light-touch review and not be drawn into the substantive merits. That is precisely what the Tribunal is required to do in the context of the A1P1 challenge.

C. GROUND 1: THE LEGALITY OF SCHEME 1

12. By way of summary, VWFS's Ground 1 is that the FCA did not have the power to make the rules in CONRED 6 establishing Scheme 1. This is essentially because:

    12.1 It is a necessary precondition to the establishment of a CRS that it appears to the FCA that "consumers have suffered (or may suffer) loss or damage" (s.404(1)(b)) (emphasis added).

[13] FCA Grounds, [123], [125.1], [133.2].

12.2 "Consumers" are defined in s.404E(1) and (2) as including (so far as relevant) "persons … who have used … services provided by … authorised persons in carrying on regulated activities".

12.3 The activity of entering into a regulated credit agreement as lender was not a regulated activity before 1 April 2014, when article 60B(1) was added to the RAO.[14] This provides: "Entering into a regulated credit agreement as lender is a specified kind of activity." The original versions[15] of article 60B(3) defined "regulated credit agreement" as "any credit agreement which is not an exempt agreement".

12.4 A borrower who entered into a motor finance agreement before 1 April 2014 was therefore not using services provided by an authorised person carrying on a regulated activity.

12.5 Scheme 1 requires the payment of redress to borrowers where (in summary) lenders (or their agents) failed to disclose to the borrowers the presence of "relevant arrangements" before the time of entering into relevant motor finance agreements.[16]

12.6 That failure can only have happened as at (and certainly no later than) the date on which the relevant agreement was entered into.

12.7 Where an agreement was concluded before 1 April 2014, the failure to disclose therefore cannot have amounted to a failure which caused loss or damage to a "consumer".

13. The FCA's response to VWFS's Ground 1 essentially boils down to a single argument (in addition to the irrelevant submission[17] that it would be inconvenient if the FCA lacked the power to impose a CRS covering the Scheme 1 period). This

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14 By article 6 of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No.2) Order 2013 (SI 2013/1881), which came into force on 1 April 2014 (see article 1(6)).

15 That is, the three versions of article 60B(3) that were in force until 2016.

16 See CONRED 6.3.10R(1), which provides that there will have been inadequate disclosure, and therefore an unfair relationship, unless specified information about "relevant arrangements" "was clearly and prominently provided to the consumer before the consumer entered into the motor finance agreement".

17 Made at FCA Grounds [57] and elsewhere.

is the argument based on the new definition of "regulated credit agreement" in article 60B(3), which was introduced on 20 March 2016.[18]

14. The new definition provides that, for the purposes of article 60B, "regulated credit agreement" means:

> (a) in the case of an agreement entered into on or after 1st April 2014, any credit agreement which is not an exempt agreement; or
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> (b) in the case of an agreement entered into before 1st April 2014, a credit agreement which—
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> (i) was a regulated agreement within the meaning of section 189(1) of the Consumer Credit Act 1974 when the agreement was entered into; or
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> (ii) became such a regulated agreement after being varied or supplemented by another agreement before 1st April 2014,
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> and would not be an exempt agreement pursuant to article 60C(2) on 21st March 2016 if the agreement were entered into on that date.

15. The FCA submits that the effect of the new definition is that "the relevant regulated activity includes agreements entered into prior to 1 April 2014",[19] and that "by virtue of Article 60B RAO, 'regulated activities' include 'regulated credit agreements' entered into prior to 1 April 2014".[20] It also submits that "'Regulated activities' for present purposes means 'regulated credit agreements'".[21]

16. These are slightly odd formulations, which appear to be designed to obscure the obvious problems with the FCA's interpretation. In particular, an "activity" cannot naturally "include", or "mean", an "agreement".[22] An activity is described by a verb; an agreement is a noun. In the present case the relevant regulated activity is

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18 When article 2(10) of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2016 (SI 2016/392) ("the 2016 Order") came into force. See: article 1(2), which provides that the 2016 Order comes into force the day after the day on which it is made for the purposes of the FCA making rules, giving guidance and imposing requirements or giving directions (i.e. 17 March 2016); article 1(3)(b), which provides that for all other purposes article 2(10)(a) (which inserts the bulk of the new definition of "regulated credit agreement") comes into force on 20 March 2016; and article 1(3)(d) which provides that the remaining provisions of the 2016 Order (including article 2(10)(b)) come into force on 6 April 2016.

19 FCA Grounds, [70].

20 FCA Grounds, [71].

21 FCA Grounds, [75.4].

22 Neither can a regulated credit agreement "be" a regulated activity (cf. the last sentence of FCA Grounds, [74]).

that of entering into a regulated credit agreement as lender, as the FCA appears to accept.

17. The question therefore is whether that regulated activity could have been carried out before 1 April 2014. The answer is that it obviously could not. The fundamental problem with the FCA's argument is that nothing in the 2016 amendments to the RAO had the effect of altering the position that article 60B(1), which created the regulated activity of "Entering into a regulated credit agreement as lender", only came into force on 1 April 2014 and can therefore apply only to agreements entered into on or after that date.[23]

18. Therefore, notwithstanding that an agreement entered into prior to 1 April 2014 may have fallen within the definition of "regulated agreement" in s.189(1) CCA, and may fall within the definition of "regulated credit agreement" following the amendments to that definition in 2016, the entry into such an agreement could not possibly have been a "regulated activity", because that activity could only have occurred from 1 April 2014 onwards.[24]

19. It is, in fact, clear that the purpose of the 2016 amendments to article 60B(3) was to clarify that agreements concluded before 1 April 2014 fell within the separate regulated activity created by article 60B(2) of the RAO (which was also introduced with effect from 1 April 2014), namely "to exercise, or to have the right to exercise, the lender's rights and duties under a regulated credit agreement". It makes obvious sense for this activity to be regulated irrespective of when the agreement was concluded, because the activity is by its nature a continuing one during the currency of the agreement, rather than an activity which can only happen once and at a fixed point in time (as under article 60B(1)).

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23 See articles 1(6) and 6 of SI 2013/1881.

24 This conclusion is consistent with the FCA's own guidance, as set out in the FCA Handbook at CONRED 1.4.4G, which states: "Where the services to which a scheme applies are those provided by authorised persons in carrying on regulated activities, the limitation to 'regulated activities' means that a consumer redress scheme cannot apply to services that were provided before the activity in question first became regulated by the FSA or FCA". The FCA is now driven to dismiss this guidance as "wrong" (FCA Grounds, [73.4.2]). Tellingly, however, it has not amended or withdrawn the guidance so as to align it with the position it has opportunistically adopted in these proceedings.

20. What the 2016 amendments certainly did <u>not</u> do, however, was to provide that the <u>entry into</u> of "regulated credit agreements" (as now defined) before 1 April 2014 was itself retrospectively to be regarded as a regulated activity notwithstanding that it was not a regulated activity when such agreements were concluded. That would have been a surprising thing for the Treasury (the relevant rule-making body) to have wished to do, and it would have required clear and express wording if this had indeed been the intention.[25] It would have far-reaching consequences beyond the incidental matter of the implications for the meaning of "consumer" in FSMA s.404E(1). The effect would be to render the entry into of credit agreements concluded before 1 April 2014 retrospectively subject to the rules in the FCA's Consumer Credit Sourcebook, regardless of the fact that those rules did not exist when the agreements were made.

21. The FCA attempts to deal with this point by asserting that it involves impermissibly "reading in" additional words to the new article 60B(3) to make it clear that limb (b) of the definition applies only to article 60B(2).[26] This is a thoroughly bad argument. There is no "reading in" required. The position is clear on the face of the provisions, and in particular from the fact that the article 60B(1) regulated activity came into force only on 1 April 2014. In these circumstances, the article 60B(3)(b) limb of the definition of "regulated credit agreement" is only <u>capable</u> of applying for the purposes of article 60B(2). There was no need for this to be spelt out expressly in the regulations, and there is no need for it to be "read in" now. It is obvious.

22. In the alternative to its primary case on article 60B(1), the FCA asserts that the lender Applicants do not "squarely confront the issue of relevant agreements which 'straddle' 1 April 2014: see Article 60B(2)".[27] This is a reference to agreements which were entered into before 1 April 2014 but continued in force after that date.

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25 Further, if that were to have been the Treasury's intention, it would have been expected to have that intention from the outset (i.e. in 2014, when article 60B was introduced into the RAO). On the FCA's case, the Treasury only appears to have had that intention in 2016 (when the definition of "regulated credit agreement" was amended), which suggests that, in reality, there was no such intention.

26 FCA Grounds, [72].

27 FCA Grounds, [74].

There is, however, nothing in this point either, and there is accordingly nothing that VWFS needed or needs to "confront" in this regard.

23. It appears from the FCA's reference to article 60B(2) in this connection that its position is that so-called "straddle" agreements would fall within Scheme 1 on the basis that, <u>after</u> 1 April 2014, lenders under such agreements were carrying out the regulated activity of exercising, or having the right to exercise, the lender's rights and duties under a regulated credit agreement.

24. It is correct that lenders under such agreements would have been carrying out that regulated activity after 1 April 2014, irrespective of when the agreements were concluded, simply by virtue of being the creditor under an agreement that had not come to an end before 1 April 2014. That does not, however, assist in the present situation. That is because Scheme 1 is not concerned, even in the context of "straddle" agreements, with any conduct post-dating 1 April 2014 (when article 60B(2) came into force). As explained above, the relevant failure in respect of which redress is available under Scheme 1 is the failure to disclose the presence of "relevant arrangements" <u>before</u> the conclusion of the agreements in question. That non-disclosure by definition happened before 1 April 2014, when neither article 60B(1) nor article 60B(2) was in force.

25. Finally, the FCA relies on s.14(2) of the Financial Services Act 2010, which provides that ss.404-404G of FSMA (which were introduced by s.14(1) of the 2010 Act) have effect in relation to failures occurring before as well as after ss.404-404G came into force (which they did on 12 October 2010).[28] The FCA relies on this in support of its argument that the new CRS regime as introduced in 2010 was intended to cover "historical breaches" with "clear retroactive effect". However, this point also does not assist the FCA's case on the present issue, for two main reasons:

    25.1 Section 14(2) of the 2010 Act is not capable of displacing the plain fact that article 60B of the RAO did not come into force until 1 April 2014, and that

[28] FCA Grounds, [63].

entering into a regulated credit agreement was therefore not a regulated activity before that date.

25.2 The fact that ss.404-404G of FSMA have "retroactive effect" as provided for in s.14(2) of the 2010 Act was obviously intended to make it clear that a CRS under the new provisions could be established in respect of failures by firms before 12 October 2010 in respect of activities that were already regulated when those failures took place. There were of course many other regulated activities specified in the RAO (which came into force in its original form on 1 December 2001) before 12 October 2010.

D. GROUND 2: THE FCA'S APPROACH TO UNFAIRNESS

26. The FCA's position in relation to VWFS's Ground 2 is based on fundamental misapprehensions as to the nature and extent of both (i) its powers under FSMA ss.404 and 404A; and (ii) the role and jurisdiction of the Tribunal under s.404D in relation to challenges to CRS rules concerning "failure to comply with a requirement". The reasons for this have been outlined in section B above, but they are explained in greater detail below by reference to this aspect of the Schemes.

27. Under a CRS, the first step required of a firm (under FSMA s.404(5)) is to "investigate whether … it has failed to comply with the requirements" specified by the FCA in the rules establishing the CRS.

28. Under the Schemes, this requirement for an "investigation" is catered for in the following terms:[29]

> The lender must presume that there was an unfair relationship in respect of a scheme case if:
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> (1) one or more of the relevant arrangements are present; and
>
> (2) there was a failure to provide adequate disclosure to the consumer of any of those arrangements that were present.

[29] CONRED 5.3.8R.

29. Moreover, lenders "must presume that there was no adequate disclosure" unless certain stringent evidentiary requirements are met (and which requirements do not reflect the FCA's own regulatory requirements at various points in time).[30]

30. Thus, inadequate disclosure of any one of the three "relevant arrangements" identified by the FCA is (subject to only limited exceptions) presumed to give rise to an unfair relationship within the meaning of CCA s.140A, which is the relevant "failure to comply with a requirement".

31. The starting point when considering the lawfulness of the FCA's approach in this regard is to recognise that inadequate disclosure of each of the three "relevant arrangements" referred to in the Schemes is an "example" falling within FSMA s.404A(1)(b). That is because they are "examples of things done, or omitted to be done, that are to be regarded as constituting a failure to comply with a requirement". This appears to be accepted by the FCA.[31]

32. It follows from this that the FCA was only entitled to include inadequate disclosure of its "relevant arrangements" as examples under s.404A(1)(b) if inadequate disclosure of each of those arrangements "[has] been, or would be, held by a court or tribunal to constitute a failure to comply with a requirement": see s.404A(2). This means that the FCA was only entitled to include inadequate disclosure of those "relevant arrangements" as examples under s.404A(1)(b) if inadequate disclosure of each of those arrangements either (i) <u>has been</u> or (ii) <u>would be</u> held by a court or tribunal to <u>constitute</u> an unfair relationship under CCA s.140A.

33. It also follows from the above that, for the purposes of the present Applications under s.404D, the Tribunal's jurisdiction when reviewing this aspect of the Schemes arises principally under s.404D(6); its general jurisdiction under s.404D(5) to apply "the principles applicable on an application for judicial review" is of little (if any) practical relevance. Under s.404D(6), the Tribunal is required to "determine whether the example constitutes a failure to comply with the requirement in question". In the present context, this means that the Tribunal must

30 CONRED 5.3.12R.

31 See, e.g., FCA Grounds at [84]-[86], where the FCA attempts to explain how the Schemes comply with s.404A(1)(b).

determine whether inadequate disclosure of any one of the FCA's "relevant arrangements" by itself constitutes an unfair relationship under CCA s.140A.

34. Two important points may be noted about the Tribunal's jurisdiction in this respect:

34.1 First, the Tribunal is required to <u>determine</u> whether inadequate disclosure of one of the relevant arrangements constitutes an unfair relationship. This obviously means that the Tribunal must decide that question, which is a question of law, for itself. The Tribunal is neither required nor entitled to approach the matter with a predisposition to favour the opinion of the FCA on this issue, or to consider whether the FCA can be said to have acted irrationally in defining its "examples". That is because the FCA's power to include "examples" in a CRS is not, for the reasons given above, an exercise of "regulatory judgement" or policy-making discretion.[32] The FCA is of course required to take a view on what the law is (under s.404A(2)) when making the relevant rules.[33] But once its assessment is challenged (under s.404D(6)), its opinion is entitled to no more respect or deference than anyone else's: the question for the Tribunal is simply "whether the FCA came to the correct view".[34]

34.2 Second, the issue that the Tribunal is required to determine is whether inadequate disclosure of each of the relevant arrangements <u>constitutes</u> an unfair relationship. It is not whether the inadequate disclosure is merely relevant to the fairness of the relationship, or (for example) whether it is "<u>capable of</u> being found by a court or tribunal to constitute",[35] or is "an indicator of",[36] an unfair relationship. The question is simply whether, as a matter of law, inadequate disclosure of each relevant arrangement <u>constitutes</u>

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32 As wrongly asserted by the FCA, e.g. in its Grounds at [86.2], [87] and [93].

33 Although the FCA has, as its own guidance acknowledges, other options available to it where the law is unclear. CONRED 1.3.11G states that the FCA may decide in these circumstances either "(1) not to develop a scheme, having regard to the other ways in which consumers can seek redress, including through the courts; or (2) to take steps to clarify the law". In the present case the FCA did not avail itself of either option.

34 See the FCA's own guidance in CONRED 1.7.6G. See also 1.7.5G, which explains that the role of the Tribunal under s.404D(6) and (7) is "to conduct a full merits review to consider whether the FCA's interpretation of the law was correct". In relation to that question, the issue of the workability of scheme rules is irrelevant: cf. FCA Grounds, [89].

35 FCA Grounds, [46] (emphasis added).

36 FCA Grounds, [108.2].

an unfair relationship. In order for that question to be answered in the affirmative, the Tribunal must be satisfied that the inadequate disclosure of each relevant arrangement would, by itself,[37] inevitably be found by a court hearing an application under CCA s.140B to give rise to an unfair relationship, regardless of any other facts of the case (such as (i) whether the disclosure of the relevant arrangement would have made any difference to the consumer and (ii) the other terms of the transaction under which the consumer acquired the relevant vehicle).

35. In VWFS's submission, it is plain that the inadequate disclosure of any one of the relevant arrangements identified by the FCA would not be found by a court hearing an application under s.140B automatically to give rise to an unfair relationship. This is clear from the approach that the courts have taken to the "unfair relationships" jurisdiction, and the significance placed on the fact-sensitive nature of the inquiry.

36. The broad nature of ss.140A and 140B, and the fact-specific focus of any inquiry into the fairness or otherwise of the relationship, was emphasised recently by the Court of Appeal in *Angel v Black Horse Limited* [2026] EWCA Civ 831, a case which directly concerned claims under s.140B in the context of commission disclosure relating to motor finance agreements.

37. The issue in *Angel* was the proper approach to case management of the thousands of claims that have been brought in the County Court in which borrowers under motor finance agreements have sought relief under CCA s.140B arising out of the allegedly inadequate disclosure of commission arrangements between the lenders under the agreements and the car dealers who arranged them. As part of its consideration of the most desirable approach to the management of the multitude of County Court claims, the Court of Appeal had regard to the nature of the inquiry required when a court is asked to make a finding of an unfair relationship under CCA s.140A. After reviewing the three leading Supreme Court cases on unfair

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[37] And subject to the limited exceptions to the presumption of unfairness arising from inadequate disclosure under the Schemes (summarised in FCA Grounds, [90.3] and [90.5]).

relationships,[38] Coulson LJ (with whom the President of the Family Division and Stuart-Smith LJ agreed) said (at [57]):

> So there can be no doubt that s.140A requires … a broad and holistic enquiry, with no limit on the factors that may be relevant to the question of the fairness of the relationship. The terms of the credit agreement, the size of the undisclosed commission, whether there has been a breach of CONC: all these may be factors in the assessment, but no more than that.

38. The reference in this passage to "the terms of the credit agreement" is particularly important, because it shows that the unfairness assessment has to take place by reference to the relationship between the parties as a whole. This explains why the FCA is wrong in its repeated assertion that it is irrelevant to the assessment whether the consumer got a "good deal" under their finance agreement. There is no reason for this factor to be uniquely excluded from the "broad and holistic" inquiry:[39] there is, as Coulson LJ said, "no limit on the factors that may be relevant to the question of the fairness of the relationship".[40]

39. The point is not that a "good deal" necessarily means that the relationship is not unfair regardless of any inadequate disclosure; it is simply that the overall terms of the transaction are relevant, along with all of the other surrounding circumstances, to the holistic assessment of fairness. Similarly, there is also no reason to exclude the question whether more fulsome disclosure would have made any difference to the consumer's behaviour or outcome.[41] Again, it is no answer to this for the FCA

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38 *Plevin v Paragon Personal Finance Limited* [2014] UKSC 61, [2014] 1 WLR 4222; *Smith v Royal Bank of Scotland plc* [2023] UKSC 34, [2024] AC 955; and *Johnson v FirstRand Bank Limited* [2025] UKSC 33, [2026] AC 877.

39 Indeed, the FCA itself acknowledges that the inquiry into liability and remedy under s.140B "are broad, multifactorial exercises": FCA Grounds, [119].

40 The FCA's attempt to neutralise the "good deal" argument is based almost entirely on the decision of Kerr J in *R (Clydesdale Financial Services Limited) v Financial Ombudsman Service Limited* [2014] EWHC 3237 (Admin), [2025] Bus LR 1323. The Court of Appeal's decision in *Angel*, however, shows why this reliance on *Clydesdale* is misplaced. As Coulson LJ said at [98], *Clydesdale* was a judicial review, so the issue for the Administrative Court was whether the ombudsman's decision was open to challenge on judicial review grounds. The passage of Kerr J's judgment on which the FCA relies ([253]-[256]) concerned the ombudsman's finding of a breach of FCA Principle 6 (rather than an unfair relationship under CCA s.140A). Notably, it was not even alleged that the ombudsman had misinterpreted Principle 6 or acted irrationally. It is therefore unsurprising that Kerr J concluded that the ombudsman had been entitled to find a breach of Principle 6 on the facts before him. Kerr J was definitely not, however, purporting to lay down any rule of general application that the terms of the credit agreement were not capable of being relevant to the assessment of fairness (whether for the purposes of Principle 6 or otherwise).

41 Something the FCA frankly accepts that it cannot establish: FCA Grounds, [95.3]. As explained in the witness statements of Alexander Young (at [46]-[48]) and Matthew Solven (at [82]-[84]),

to say that a causal link is "not required to prove s.140A unfairness".[42] It is true that this is not necessarily required in all cases, depending on the facts (as the *Johnson* case, with its extreme facts, demonstrates); but it does not follow that the potential impact of the relevant information being disclosed can simply be excluded across the board as *ipso facto* irrelevant.

40. The FCA accepts that the issue of the fairness of a credit relationship under s.140A is "highly fact-sensitive" and requires consideration of "a very broad range of factors".[43] Yet the Schemes prohibit firms from taking into account many of the factors which a court would consider to be relevant to this issue.[44] In addition to the terms of the credit agreement and whether full disclosure of "relevant arrangements" would have made any difference, there are many other factors that a proper assessment of fairness would take into account but which are precluded under the Schemes. These include, among other things, whether there was some disclosure in (e.g.) a "key facts" document (even if not in full compliance with the Scheme requirements), such that the consumer could have found out about the commission if they had taken the trouble to ask; whether the APR under a DCA was close to the lower end (but not right at the bottom) of the spectrum; and the existence of benefits in the form of subvention from the vehicle manufacturer.[45]

41. One of the issues considered by the Court of Appeal in *Angel* was whether the large number of County Court claims should be left to proceed individually, or whether there should be lead cases. As part of its assessment of that question, the Court of Appeal had to consider whether it was possible to identify common points of principle which could be decided and then applied across the wider population of

VWFS's experience since introducing enhanced disclosure practices following the decision of the Court of Appeal in *Johnson* has been that there has been no material change in the terms of its agreements (e.g. in terms of APRs) or the levels of commission paid to dealers.

42 FCA Grounds, [95.3].

43 FCA Grounds, [87].

44 As Mr Theodosiou acknowledged in [17] of his witness statement: "The Schemes do not purport to replicate the holistic and multi-factorial assessment a court would make of each individual claim being progressed through the courts."

45 The nature and (significant) extent of such subvention in the context of VWFS's agreements is explained in the witness statements of Alexander Young (at [19]-[30]) and Matthew Solven (at [32]-[46]).

cases. The Court of Appeal's reasoning on that issue is important, and has significant implications for the Schemes in this case.[46]

42. Coulson LJ began his consideration of this issue as follows (at [87]):

> It is worth starting with the question of unfairness. The circuit judge decided that, since the unfair nature of the relationship would differ in every case, it was impossible to identify a common issue that could deal with unfairness in principle. The High Court judge agreed with that at [73]. I agree with it too. To that extent, therefore, the High Court judge was wrong to identify as part of the common issues exercise what he called cases where there was a very clear case of unfairness: see [28], [29], [32] and [79]. He appears in these passages to indicate that there may be cases where the size of the commission alone would justify a finding of unfairness. I consider that that is wrong in principle: it is contrary to [326] in *Johnson*, which reiterated that the size of the commission alone will not equate to unfairness. It is simply a relevant factor: see [319]. I consider that [counsel] is probably right to say that in this particular area of law, there may well be no such thing as a "very clear case" or "tipping point case".

43. Coulson LJ went on (at [90]) to reject what he regarded as:

> the claimants' continuing attempt to tilt what is supposed to be a level playing field, where everything is potentially relevant, towards some sort of presumption of an unfair relationship. It is simply not appropriate for the court to give undue weight to any one particular factor over another: it is for the court to evaluate all relevant factors in order to come to a conclusion as to the nature of the relationship.

44. Finally, Coulson LJ referred (at [91]) to:

> the Supreme Court (and other authorities) which have repeatedly set their face against any sort of presumption or modification to the principle that unfairness is an entirely fact-specific inquiry. Accordingly, to the extent that there is any doubt about it, I repeat what both judges below said, that there can be no question of any common issue that directly addresses the issue of unfair relationships without regard to the facts.

45. These observations obviously have stark ramifications for the Schemes in this case, which operate on the basis of presumptions of unfairness (and the use of "tipping

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46 The *Angel* decision was handed down shortly before the FCA Grounds were served. It gets a brief mention in a footnote in the Grounds (footnote 134), but the FCA has not grappled with the significance of the decision, as explained below, in the context of these proceedings. For the avoidance of doubt, whilst the *Angel* decision was handed down after the Schemes were made, as a matter of precedent, it did not change the law as neither the common law nor the meaning of the Civil Procedure Rules changed.

points") without regard to the facts. They are, in Coulson LJ's words, very much not "a level playing field".

46. At [105], Coulson LJ referred to the Schemes in this case, on which the claimants had relied in support of their submission that it was possible to isolate "common issues" relating to the issue of unfairness. Coulson LJ gave this argument short shrift:

> I should add that, on this question of common issues, I derived little assistance from the FCA scheme for compensation, on which the claimants relied at the hearing. It is a separate scheme, which operates on the basis (which the law does not) that non-disclosure of the commission creates a rebuttable presumption of an entitlement to compensation.

47. It is obviously true, as Coulson LJ said, that the Schemes' use of rebuttable presumptions of unfairness and entitlement to redress means that the Schemes operate in a way "which the law does not". But the whole point of the FSMA statutory scheme considered above is that the FCA is not entitled to establish a CRS which operates in a way "which the law does not". In its design of these Schemes, the FCA has failed to respect this critical limitation.

48. If, contrary to the above, judicial review principles apply, this aspect of the Rules remains unlawful for the reasons set out at [52.4] of VWFS's Grounds. It is irrational, and contrary to the objects and purposes of ss.404 and 404A, to use presumptions of unfairness and entitlement to redress where the relevant arrangements would not be held by a court or tribunal to constitute an unfair relationship under CCA s.140A.[47]

49. As regards A1P1, the FCA in its Grounds (in a section titled "Issue 8") contends: (i) that A1P1 is not engaged at all; (ii) that the Scheme is made "in accordance with law" because of the power under s.404 FSMA; and (iii) that if A1P1 is engaged, then any interference is proportionate, given the broad discretion that is said to be conferred on the FCA in the present context.

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47 As is clear from the structure of VWFS's Grounds, VWFS relies on all of the points set out at [38]-[52] (as supplemented in this Reply) in support of the judicial review grounds particularised at [52.4]. The suggestion by the FCA that these grounds are "unparticularised" is wrong.

49.1 As to (i), this is wrong in law (as the FCA may accept, given the careful language used at [256]). The Schemes directly interfere with the assets of VWFS. That is a paradigm interference with A1P1 possessions (as confirmed in *AXA General Insurance v Lord Advocate* [2012] 1 AC 868, [113]-[114], cited by the FCA at fn 176 of its Grounds). The FCA appears to suggest that the fact that there will be significant overlap between existing liability and the Schemes means that there is no interference with possessions (at FCA Grounds [256]). No authority has been identified which supports that proposition, and, in any event, the core premise of Ground 2 is that the Scheme is creating an entitlement to redress in circumstances where a court or tribunal would not find an unfair relationship.

49.2 As to (ii), the FCA's position is only good if it is right in respect of all of the grounds. But if it has exceeded its statutory power, then that aspect of the Scheme will not have been made "in accordance with law" and there will be an infringement of A1P1 irrespective of whether the interference is proportionate.

49.3 As to (iii), VWFS accepts that the four-stage review will apply, and that some margin of appreciation will apply to the FCA (although VWFS does not accept that it is as wide as the FCA appears to suggest). In the context of Ground 2, VWFS considers that the second, third and fourth limbs are not satisfied: (ii) the relevant Rules are not rationally connected to the otherwise legitimate objectives of the Scheme; (iii) the objectives could be achieved through less intrusive means; and (iv) a fair balance has not been struck.

E. <u>GROUND 3: THE FCA'S APPROACH TO CAUSATION OF LOSS</u>

50. Under a CRS, the second step required of a firm (if it finds a failure to comply with a requirement at step 1) is (under FSMA s.404(6)) to "determine whether the failure has caused (or may cause)[48] loss or damage to consumers".

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48 The "or may cause" limb reflects the alternative "or may suffer" condition to the establishment of a CRS under FSMA s.404(1)(b). It is, however, irrelevant in the present context. As the FCA has itself explained (in CONRED 1.3.8G), "[t]he relevance of the 'may suffer' wording is that it makes clear that schemes may cover cases where loss is foreseeable but may not yet have crystallised (e.g. pensions mis-selling cases where the loss may not crystallise until retirement)." In the present case,

51. Under the rules made by the FCA governing the Schemes in this case, that "determination" is required to be carried out as follows:

51.1 In the first place, CONRED 5.3.21R provides:

> If the lender determines there was an unfair relationship in respect of a scheme case, the lender must presume that the unfair relationship caused the consumer loss or damage.

51.2 There is then provision for this presumption to be rebutted, but only in the very limited circumstances set out in CONRED 5.3.22R, and subject to the strict evidentiary requirements set out in CONRED 5.3.23R. The number of cases where rebuttal is available under these provisions is likely to be extremely small.

51.3 Finally:

> If the presumption of loss and damage is not rebutted, the lender must determine that the unfair relationship caused the consumer loss or damage.[49]

52. Thus, the effect of the Scheme rules is for practical purposes to reduce the required "determination" of whether a failure caused loss or damage to a mere formality, which appears to have been included in the Schemes only so that the FCA can claim to have complied with the requirement (under s.404(6)) for a CRS to provide for such a determination as a condition to the availability of redress.

53. The rules set out above (as appears to be common ground) fall within FSMA s.404A(1)(c)(ii), in that they are rules:

> setting out, in relation to any specified description of case, matters to be taken into account, or steps to be taken, by relevant firms for the purpose of … determining whether [a failure to comply with a requirement] has caused (or may cause) loss or damage to consumers.

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any loss or damage would have been suffered at the point of contracting, so the forward-looking "may suffer" basis for imposing a CRS is not applicable. It is important to recognise, however, that the formulation in FSMA is "may suffer" and not "may have suffered". There is therefore no power to establish a CRS in respect of existing loss in the absence of a determination that such loss has in fact been suffered.

[49] CONRED 5.3.25R.

54. However, rules under s.404A(1)(c)(ii) may not set out matters to be taken into account for the purpose of determining whether a "failure to comply with a requirement" caused loss or damage to consumers if those matters have not been, or would not be, taken into account by a court or tribunal for the purpose of that determination. This is expressly stated in FSMA s.404A(3):

> Matters may not be set out in the rules as a result of subsection (1)(c) if they have not been, or would not be, taken into account by a court or tribunal for the purpose mentioned there.

55. The Tribunal's jurisdiction to review rules made by the FCA under s.404A(1)(c)(ii) is created by s.404D(7), which provides as follows:

> If (or so far as) an application relates to a matter set out in the rules as a result of section 404A(1)(c), the Tribunal may determine whether the matter should be taken into account as mentioned in that provision.

56. Under this provision, the Tribunal is required to decide for itself whether the matters required by the FCA's rules to be taken into account for the purpose of determining whether a "failure to comply with a requirement" caused loss or damage to consumers either (i) have been, or (ii) would be, taken into account by a court or tribunal for the purpose of that determination.[50] If not, it will follow that the FCA has infringed the limitation imposed by s.404A(3), and the rules must be quashed.

57. VWFS's position in relation to this aspect of the Schemes, as set out in Ground 3 of its Grounds, is simple:

    57.1 A court would not determine whether a given failure by a defendant had caused loss or damage to a claimant by simply presuming that the failure had caused loss or damage. That is not how the courts proceed.

    57.2 A court would instead allow a lender a procedurally fair opportunity – consistent with its Article 6 rights – to present its evidence and argument in respect of all relevant matters as might demonstrate the fairness of the relationship. Then and only then would it determine, in the context of all the facts, whether a failure had caused loss or damage by considering what would have happened but for the relevant failure. Where the failure consists of an

[50] As acknowledged by the FCA in its own guidance: CONRED 1.7.5G and 1.7.6G.

omission to disclose required information, the court would approach the matter by considering what would have happened if the information in question had been disclosed.

57.3 If the result of that inquiry is that disclosure would probably have made no difference to what actually happened (whether in terms of the consumer's decision to proceed with the transaction or the overall cost of acquiring the vehicle), it will follow that the failure did not cause loss or damage to the claimant. If, on the other hand, disclosure would have altered what happened, the claimant's loss or damage would in principle fall to be measured by comparing the claimant's actual position with the position he would have been in if the required disclosure had been made.

58. It follows that the Scheme rules requiring lenders to presume that an unfair relationship caused the consumer loss or damage, without any regard to what the effect of disclosure would have been (either generally or in particular cases), were not a lawful exercise of the FCA's powers under FSMA s.404A(1)(c)(ii) and (3). They must therefore be quashed.

59. None of the various points made by the FCA in its Grounds comes close to dealing with this fundamental problem with the way in which the Schemes have been designed. Three main strands of argument appear to be made.

60. The FCA's <u>first</u> point is that it would (it submits) be "remarkable" for "firms who are responsible for widespread failures … simply [to] be left to determine whether those failures caused loss".[51] But this is not what VWFS says should happen, and this submission rests on a mis-statement of VWFS's position.[52] The point is not that firms necessarily should simply be given an open-ended discretion to determine whether a failure caused loss (which would in any event be subject to oversight by both the FCA and the FOS); it is simply that lawful CRS rules cannot require firms

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51 FCA Grounds, [112.2]; see also [132].

52 The FCA's position in this respect is also inconsistent with its own description, elsewhere in its Grounds (e.g. at [125.2]), of the investigations required under a CRS as being "firm-led". It is true that FSMA envisages "firm-led" investigations and determinations, as is apparent from s.404(5)-(7). As explained in VWFS's Grounds (at [58]-[59]), the presumption of loss and damage required by the Schemes effectively displaces the mandatory requirement (under s.404(6) and (7)) of a determination by the firm as to whether the relevant failure caused loss or damage, and it is therefore *ultra vires*. It appears to VWFS that the FCA Grounds at [125.2] effectively concede this point.

to "determine" whether a failure caused loss or damage by taking into account matters that a court would not. A court would not approach this issue by applying any sort of presumption, still less one which requires causation of loss to be presumed on a blanket and undifferentiated basis with no attempt to quantify the extent of loss or damage caused by the relevant failure.

61. The FCA's <u>second</u> point is the familiar one that its power to make rules concerning the determination of causation of loss requires it to exercise its "regulatory judgement", and that this "includes a predictive or speculative discretion to identify or conjecture what a court 'would' do in a given (possibly unprecedented) situation".[53] The FCA submits that the output of this speculation and conjecture "should be afforded considerable deference" because of the FCA's expertise as a regulator of financial services and consumer credit.

62. For reasons which have already been explained, this is all entirely mistaken. The FCA's expertise as a regulator of financial services and consumer credit is irrelevant to the present inquiry, which is whether the Scheme rules require firms to take into account matters which a court would not for the purposes of determining whether a failure caused loss or damage. That is a question of law for the Tribunal (under FSMA s.404D(7)), and for the reasons given above it plainly admits of only one answer – i.e. "Yes". Respect for the FCA's "regulatory judgement" might potentially come into play if the relevant question were only whether the FCA had acted irrationally in designing the Scheme rules as it has;[54] but under s.404D(7) that is not the question.

63. The FCA's <u>third</u> point is that its approach to causation of loss in the Schemes is justified by what it calls the "attenuated role of causation, loss and damage in the s.140A context".[55] There are three main reasons why this argument is wrong and does not assist the FCA's defence of its Schemes.

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53 FCA Grounds, [117].

54 As (wrongly) implied e.g. at FCA Grounds, [133.3].

55 FCA Grounds, [123]; see also [125.1] and [133.2].

64. In the first place, the FCA proceeds on the basis that issues of causation of loss are essentially irrelevant in the CCA s.140A context, so that they can be similarly disregarded in the Schemes.[56] This, however, is incorrect.

64.1 While it is true that courts hearing applications under CCA s.140B are not formally required to apply the rules on causation of loss that would be applicable in a claim for damages for breach of contract or in tort, issues of causation of loss are nonetheless highly material to the questions of both unfairness and remedy. This point was made by Lord Leggatt in *Smith* at [25]:

> [A]s well as requiring the court to make a very broad and holistic assessment to decide whether the relationship between the creditor and the debtor is unfair to the debtor, the legislation also gives the court, where a determination of unfairness is made, the broadest possible remedial discretion in deciding what order, if any, to make under s.140B. Section 140B gives the court an extensive menu of options from which to select but says nothing at all about how this selection may or should be made. On the face of the legislation the court's discretion is entirely unfettered. It is, I think, clear that the court is not in these circumstances required to engage in the kind of strict analysis of causation, loss and so forth that would be required, for example, in deciding what remedy to award in a claim founded on the law of contract or tort. Some constraint is, however, imposed by consideration of the general purpose of an order under s.140B. In principle, the purpose must be to remove the cause(s) of the unfairness which the court has identified, if they are still continuing, and to reverse any damaging financial consequences to the debtor of that unfairness, so that the relationship as a whole can no longer be regarded as unfair.

64.2 The importance and relevance of causation issues in this context was also emphasised by Coulson LJ in *Angel* (at [57], which has been partly set out in paragraph 37 above):

> The terms of the credit agreement, the size of the undisclosed commission, whether there has been a breach of CONC: all these may be factors in the assessment [of the fairness of the relationship], but no more than that. And this wide range of factors may also be relevant to the issue of the precise

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56 See, e.g., the witness statement of Mr Theodosiou at [85], in the context of commercial ties: "the FCA does not consider that empirical evidence of loss is a necessary precondition to conclude that unfairness from an undisclosed tied arrangement could lead to consumer loss." The FCA's position on the relevance of causation of loss is not, however, entirely consistent. In defending how it approached the threshold under FSMA s.404(1)(b) for introducing the Schemes, the FCA refers to "its own expert analysis of harm to consumers (including empirical analysis)" (FCA Grounds, [124]). But when it comes to its defence of the presumption of loss under the Schemes, the FCA tries to underplay the importance of causation of loss in the CCA s.140A context.

remedy awarded to a successful claimant, which should approximate, as closely as possible, to the overall position that would have applied had the matters giving rise to the perceived unfairness not taken place: *Farol Holdings Ltd v Clydesdale Bank PLC* [2024] EWHC 593 (Ch) at [767]. […]

64.3 It follows that, even in the context of an application to the County Court under CCA s.140B, the Court is required to have regard to what would have happened if the matters giving rise to the relevant unfairness had not taken place. In the present context, where the relevant unfairness is the inadequate disclosure of specified information, the pertinent inquiry is as to what would have happened if the specified information had been adequately disclosed. The Schemes do not take this into account at all.[57]

65. Secondly, whatever the position may be in the context of applications to the County Court under CCA s.140B, this is of very limited relevance given that Parliament has imposed different and more restrictive conditions on the establishment of a CRS under FSMA s.404.

65.1 As set out above, one of the required steps under a CRS is "for the firm to determine whether the failure has caused (or may cause) loss or damage to consumers" (s.404(6)). Further, the rules in the Schemes on this issue were made by the FCA purportedly in exercise of its power under s.404A(1)(c)(ii) to set out matters to be taken into account for the purpose of "determining whether … a failure has caused (or may cause) loss or damage to consumers".

65.2 It is therefore clear that it is a precondition to the availability of redress under a lawful CRS that the relevant failure has been <u>determined</u> to have <u>caused</u> loss or damage to the consumer. The concept of causation of loss or damage is an entirely conventional one, with an established meaning. It requires an

[57] The FCA seeks to justify its use of presumptions, including of loss and damage, on the basis that, under CCA s.140B(9), in any application to the court under s.140B(2), where "the debtor or a surety alleges that the relationship between the creditor and the debtor is unfair to the debtor, it is for the creditor to prove to the contrary" (see FCA Grounds, [138]). This is a bad argument for at least two reasons. First, a claimant in court proceedings under s.140B must still prove the facts on which he relies before the burden moves to the lender to prove the fairness of the relationship. Secondly, and crucially, the lender is afforded the opportunity to adduce evidence to show the fairness of the relationship, which is not possible under the Schemes.

inquiry into what would have occurred in the counterfactual scenario in which the relevant failure (in this case inadequate disclosure) did not happen.

65.3 When legislating to create the CRS regime under FSMA s.404, Parliament must be taken to have used the concept of causation of loss in this established sense, given the absence of any contrary indication in the statutory wording. There is therefore no basis on which the clear language of the legislation can or should be watered down and given a special "attenuated" meaning where the relevant "failure" consists of an unfair relationship under CCA s.140A. The meaning of the relevant provisions of FSMA is clear, and cannot vary according to the type of failure a particular CRS is designed to cover.

65.4 The FCA has candidly acknowledged that it has formulated the Scheme rules on loss and damage in the way that it has because it cannot demonstrate that the disclosure of "relevant arrangements" would have led to materially different outcomes for consumers.[58] Not only that, but the analysis that the FCA was able to carry out on the causal impact of disclosure suggested that "the positive impacts of disclosure may be limited and that trials involving disclosure and consumer behaviour show 'modest effects'".[59] It is very difficult to understand why, against that background, the FCA felt able to impose a blanket presumption that essentially all borrowers under motor finance agreements suffered loss or damage as a result of the inadequate disclosure to them of the presence of one or more of the FCA's "relevant arrangements".

65.5 For the reasons given above, this was not a permissible approach: the lack of evidence of causal impact of (what is now seen as) inadequate disclosure ought to have led the FCA to conclude that the statutory conditions for the establishment of a CRS are not satisfied, and that it could not lawfully make rules requiring firms to presume causation of loss or damage in these circumstances. Instead, the FCA has unconvincingly sought to justify its

58 See, e.g., CP25/27 Technical Annex 1 at [2.5]-[2.7]; PS26/3 Technical Annex 1 at [4.78]-[4.81]. See also FCA Grounds at [95.3], in which the FCA readily accepts there was "insufficient data to test empirically a link between inadequate disclosure of the 'relevant arrangements' and impact on behaviour or outcomes".

59 Witness statement of Katherine Collyer, [36].

approach with unevidenced, vague, speculative and highly caveated statements such as the following: [60]

> Had those [relevant] arrangements been disclosed, **some** people **may** have taken steps to **mitigate** the impact of those incentives on prices. The failure to adequately disclose the terms of relevant arrangements **could** have therefore given rise to an unfair relationship which in turn **may** have caused the consumer loss or damage.

66. Thirdly, even on its own terms, the alleged "loss or damage" on which the FCA appears primarily to rely for the purposes of the Schemes is unjustifiable.

66.1 Instead of approaching the question of causation of loss on the required, conventional, basis, the FCA has sought to justify its design of the Schemes principally by reference to the alleged loss caused to consumers by the presence, rather than the inadequate disclosure, of "relevant arrangements".

66.2 For the reasons given above, this is legally the wrong approach to the issue of causation of loss by reason of inadequate disclosure, and the FCA has only designed the Schemes in this way because of its acknowledgement that it cannot demonstrate causation of loss applying conventional principles. But the fact that the "right" question on causation of loss may be difficult or even impossible to answer (or may lead to an answer that is unwelcome or inconvenient) is not a licence to approach the issue by asking a different and legally irrelevant question.

66.3 However, even if this were the correct way to approach the issue (which it is not), the FCA's analysis of the extent to which loss was allegedly caused by the presence in the market of the three identified "relevant arrangements" is in any event flawed. In summary:

(a) As regards DCAs, the FCA's analysis leading to the conclusion that the presence of a DCA caused consumers to pay higher credit costs (17% for Scheme 2 and 21% for Scheme 1) is flawed for the reasons given in VWFS's Grounds at [79]-[82]. Indeed, the FCA's own

60 Witness statement of Katherine Collyer, [34] (emphasis added). See also the statement of Mr Theodosiou at [22]. To similar effect is the speculative assertion (FCA Grounds, [124]) that inadequate disclosure of relevant arrangements had the "propensity" to "impact on consumer behaviour and pricing".

analysis suggested that 44% of consumers actually benefitted from DCAs.[61]

(b) In relation to the other two relevant arrangements (high commission and commercial ties), the FCA does not even pretend to have any sort of evidential basis for requiring firms to presume that their inadequate disclosure caused consumers loss or damage.[62] It is clear from the description in the FCA's evidence of the process which led to the establishment of the Schemes that these aspects were at a late stage shoe-horned into a project which had previously been focused only on DCAs. The decision to try to graft these additional "relevant arrangements" onto the scheme as ultimately consulted on seems to have been taken because of an erroneous view at the FCA that this was required by the Supreme Court decision in *Johnson*.[63] But the FCA has been unable to demonstrate that even the presence of these two arrangements in motor finance contracts, never mind their inadequate disclosure, caused consumers loss or damage.[64] It just decided to include them in the Schemes anyway – another decision which the FCA purports to justify by reference to "regulatory judgement".[65]

67. If, contrary to the above, judicial review principles apply, this aspect of the Rules remains unlawful for the reasons set out at [67] of VWFS's Grounds. It is irrational, and contrary to the objects and purposes of FSMA ss.404 and 404A, to make rules under ss.404 and 404A in circumstances where it could not reasonably and/or rationally have appeared to the FCA that consumers have suffered loss or damage

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61 FCA CP19/28 at [115].

62 In fact, the available evidence positively suggests that enhanced disclosure of such commission arrangements would have made no difference to consumer outcomes: see [46]-[48] of the witness statement of Alexander Young, which describes VWFS's experience that enhanced disclosure practices introduced by VWFS following the Court of Appeal's decision in *Johnson* have made no material difference to the terms of VWFS's agreements with consumers or the levels of commission paid to dealers.

63 See, e.g., the witness statement of Mr Gluckman at [42], [43].

64 See the unconvincing justification for this approach in Mr Gluckman's statement at [68]-[70], and also the somewhat impenetrable explanation offered by Ms Collyer at [111] (which nevertheless acknowledges that the FCA found no causal relationship between commission levels and cost of credit – see also [114]-[115]).

65 Ms Collyer at [116]; Mr Gluckman at [53]; and Mr Theodosiou at [85]-[87].

as a result of inadequate disclosure of "relevant arrangements".[66] As regards A1P1, the points set out at paragraph 49 above are repeated.

F. GROUND 4: THE FCA'S APPROACH TO REDRESS

68. VWFS's position in relation to the Schemes' approach to redress is set out in its Grounds at [68] to [88]. The FCA's Grounds of Response, which deal with the issue of redress at [143] to [178], do not adequately address the fundamental shortcomings in the FCA's approach.

69. The FCA's approach to the issue of redress is vitiated by the underlying structural problems in its approach to the requirement of causation of loss, as set out above. Indeed, the fundamental vice in the FCA's approach is that it treats the issues of causation of loss and redress as entirely distinct inquiries, with no necessary or rational connection between the two. The Schemes treat the requirement of causation of loss as a threshold issue which, once overcome (by the fiction of a presumption as addressed above), opens up a very limited menu of redress options entirely divorced from the loss or damage identified (or rather presumed).

70. This approach is fundamentally misconceived. The reason why the Schemes proceed in this way is that the presumption of causation of loss operates in an entirely binary, undifferentiated and unquantified way. A determination that a failure has caused loss or damage cannot logically be made without some identification or quantification of the loss or damage in question. When it then comes to the issue of "what the redress should be in respect of the failure",[67] in principle the redress should obviously be designed to compensate consumers for the loss or damage that they have actually suffered as a result of the relevant failure. But that is not how the Schemes operate: the question of whether inadequate disclosure caused loss to the consumer is presented as a simple "yes/no" question, to which the answer will almost always be "yes". The answer to this question is therefore incapable of informing what the redress should be. The redress issue is

[66] As is clear from the structure of VWFS's Grounds, VWFS relies on all of the points set out at [53]-[66] (as supplemented in this Reply) in support of the judicial review grounds particularised at [67]. The suggestion by the FCA that these grounds are "unparticularised" is wrong.

[67] See FSMA s.404(7).

therefore left entirely at large, divorced from any consideration of the loss in respect of which redress ought to be made.

71. For the reasons given above in relation to Ground 3, a presumption of causation of loss which operates in this way is not permissible under the FSMA regime, and the Schemes must therefore be quashed for that reason. But even if, contrary to VWFS's submissions on Ground 3, a blanket and binary presumption were a legitimate approach to the issue of causation of loss, the Schemes' approach to the issue of redress would nevertheless still be unlawful.

72. It is accepted that, as the FCA submits, if one gets this far in the analysis, any challenge to the Scheme rules on redress falls to be made under s.404D(5) (rather than the "primary" jurisdiction under sub-sections (6) and (7) which apply to the issues of unfairness and causation of loss respectively), and that the governing principles are therefore those which apply on an application for judicial review. The question is therefore whether the FCA was lawfully entitled to consider that its rules on redress are "just" within the meaning of s.404A(4). Even on that basis, however, the rules are unlawful and should be quashed. This is principally because, in making the rules, the FCA has failed to have due regard, as required by s.404A(5), to "the nature and extent of the losses or damage in question". Instead, the FCA seems to have taken the view, wrongly, that s.404A(4) gives it an entirely free hand in relation to CRS rules relating to redress. This is incorrect: s.404A(4) in fact contains a limitation on the FCA's rule-making powers, which are in any event subject to the other restrictions described in this section of VWFS's Reply, including under s.404A(5).

73. In this connection, it is critical to the assessment of the lawfulness of the Scheme rules on redress that the losses or damage in question (and to which the FCA is required to have regard under s.404A(5)) are obviously those which have been caused by the failure in respect of which redress is to be awarded. In the present case, that means losses or damage caused by the inadequate disclosure of "relevant arrangements" in motor finance contracts.

74. The real question is therefore whether the Scheme rules on redress have a sufficient connection to the loss or damage caused by the inadequate disclosure of "relevant arrangements", such that the making of the rules was a lawful exercise of the FCA's

powers. In VWFS's submission, the answer to that question is that there is obviously no such sufficient connection. Indeed, the FCA in its Grounds of Response does not seriously contend that there is: its position is rather that it was under no obligation "to 'target' financial loss" or seek to "put consumers into the position they would have been in but for the relevant failing",[68] despite the requirement in s.404A(5) to have regard to the nature and extent of the losses or damage actually caused by inadequate disclosure. Instead, the FCA submits, it was entitled to "arrive at the methodology which best served its objectives and regulatory priorities".[69]

75. In the premises, the FCA acted unlawfully for all of the reasons set out at [88] of VWFS's Grounds. As to A1P1 specifically, paragraph 49 above is repeated.

76. The FCA has also acted contrary to its own guidance, which states in terms that "the FCA cannot disregard the normal legal rules on causation or remoteness of loss".[70] The Scheme rules on redress in effect have no regard at all to any loss or damage that might conceivably have been caused by inadequate disclosure of relevant arrangements. This is essentially for the reasons outlined under Ground 3 above, but in summary the defects inherent in the two forms of redress available under the Schemes are as follows.

77. As for the so-called "commission repayment remedy",[71] this is obviously not designed to be at all compensatory in nature, and it bears no relation to any loss that can be said to have been caused to the consumer by the inadequate disclosure of any of the relevant arrangements, whether alone or in combination. For this to be the case, the theory underpinning the remedy would have to be that if the broker

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68 FCA Grounds, [156].

69 FCA Grounds, [157]. It is notable that when listing its regulatory objectives, (e.g., FCA Grounds, [26]), the FCA makes clear that it was concerned with "fair", "timely" and "consistent" outcomes. Nowhere did the FCA suggest that its objective was to create a CRS which would even attempt to mirror the outcomes of litigation in the event that individual claims were to be pursued. Indeed, it is clear that the FCA sacrificed the requirement to mirror judicial outcomes on the altar of speed and uniformity. The FCA expressly acknowledged in internal documents prior to the publication of the Schemes that "no consumer would receive" the level of compensation mandated under the Schemes if their complaints were pursued by way of litigation in court (see [FCA00000032] at p.14).

70 CONRED 1.5.12G.

71 This is not an accurate description of the effect of the remedy because borrowers under motor finance agreements do not themselves pay commission: it is paid by the lender to the broker. There is therefore no commission to be "repaid" to the borrower.

had made full disclosure of its commission arrangements with the lender, (i) the borrower would have insisted on all of the commission to which the broker was entitled being paid over to himself, and (ii) the broker would have agreed. This is obviously absurd.

78. Turning to the "hybrid" remedy (to which most consumers would be entitled under the Schemes), this has also not been designed so as to have regard to the loss or damage caused by the inadequate disclosure of "relevant arrangements" in motor finance contracts. It is an amalgamation of two inputs which are themselves not designed to answer (or even have regard to) that question; the output can be no better than the inputs. The "commission repayment" remedy has already been addressed, but the other element of the hybrid remedy calculation, namely the APR adjustment, is also not properly directed at the loss which can be said to have been caused by inadequate disclosure.

79. As explained above in relation to Ground 3, the APR adjustment represents, at any rate in relation to Scheme 2, at least some kind of attempt by the FCA to quantify the effect of DCAs on credit costs,[72] although it does so in an inadequate and inaccurate way.[73] But for the reasons already given, that is not the right approach: the relevant failure was the inadequate disclosure of DCAs, not the existence of these arrangements (which at the time were perfectly lawful) in the first place. An

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72 As explained above, it does not even purport to do that in relation to Scheme 1, or for either of the non-DCA relevant arrangements in both Schemes (i.e. high commission and commercial ties). It is therefore difficult to understand why the FCA felt able to impose the same 17% APR adjustment under Scheme 2 where the only relevant arrangement is a high-commission arrangement or a commercial tie. The FCA's disclosure suggests that this was another decision taken in the interests of "simplicity, cost-effectiveness, transparency, and timeliness", despite the fact that an APR adjustment developed for DCAs "may not accurately reflect consumer loss" caused by the two other relevant arrangements (FCA1/704, [4.25]). Moreover, the 21% APR adjustment which applies to Scheme 1 is not based on any attempt to measure the impact of DCAs (or either of the other relevant arrangements) on credit costs: the figure is entirely arbitrary (and not in any sense loss-based), representing the approximate mid-point between the 17% used for Scheme 2 and 26% (this being the point at which, according to the FCA, hybrid remedy redress amounts, on average, to commission repayment redress: PS 26/3, [1.30]).

73 Even on the FCA's (impermissible) approach of attempting to measure the impact of DCAs as some kind of "proxy" for the impact of non-disclosure of DCAs, the FCA's approach is flawed and irrational. This is because the FCA has not compared like with like (including due to the uneven distribution of subvention between DCA and non-DCA loans as explained further below). The FCA has also, without proper justification, closed its mind to other analysis that showed no difference between DCA and non-DCA APRs (see [FCA00000437], which showed materially different results when DCAs are compared with post-ban non-DCAs rather than pre-ban non-DCAs). For the FCA in these circumstances to have adopted a 17% APR adjustment for all Scheme 2 loans, and also to have used this as a starting point for the 21% used in Scheme 1, is irrational.

assessment of the loss caused by the inadequate disclosure of the relevant arrangements requires a counterfactual investigation into what would have happened if full disclosure had been made. The FCA's APR adjustment, even if it were a freestanding remedy of its own (which it is not, as its only purpose is to supply one element of the hybrid remedy calculation), would not assist in answering that question. The APR adjustment could only be defensible if full disclosure would have resulted in consumers' borrowing costs being reduced by the amount of the adjustment. But the FCA rightly does not suggest that there is any basis for concluding that this is what would have happened.

80. As with the issue of causation of loss, the FCA has sought to justify its approach to the Scheme rules on redress by relying on the Supreme Court's decision in *Johnson*, where the borrower was awarded a remedy under CCA s.140B corresponding to the "commission repayment" remedy under the Schemes. For the reasons already explained under Ground 3, however, the *Johnson* case does not support the FCA's position. That is because FSMA has not endowed the FCA with the same broad remedial discretion as courts have under the CCA. The FCA's powers in relation to redress are more limited, and are designed to ensure that consumers are compensated for loss or damage that they have actually suffered as a result of the particular failure addressed by the CRS. The FCA is not permitted to require firms to make redress to consumers on a basis which is avowedly not designed to compensate consumers for such loss or damage.

81. A further critical defect in the Schemes' approach to redress is the FCA's failure to take account of subvention in motor finance contracts, which is a very significant (and, to consumers, valuable) aspect of the captive lending market in particular. The FCA asserts that it has "considered contexts involving subvention and made provision for them",[74] citing the examples of "zero APR" and "5th percentile non-zero APR" cases, which attract nil redress. But the reality is that the FCA has effectively ignored the important phenomenon of partial subvention, where consumers obtain benefits, subsidised by vehicle manufacturers, such as discounted APRs, deposit contributions and service packages.[75] The effect of this will be that

[74] FCA Grounds, [173.1].

[75] See [24]-[25] of the witness statement of Alexander Young, which explains the scale of subvention across VWFS's portfolio. The FCA's decision effectively to disregard the important benefits

consumers will be entitled to redress in situations where they have no reasonable ground for complaint at all. VWFS will seek permission to rely on expert evidence which will address whether, and (if so) to what extent, the FCA's failure adequately to take into account partial subvention and/or other aspects of the vehicle transaction: (1) resulted in an over-estimate of the difference in APR derived from the FCA's comparison of DCAs and non-DCAs;[76] and (2) has consequently led to an over-statement of consumer harm or loss.

82. It appears that the FCA seeks to justify its approach in this respect by its insistence that the "good deal" argument is "wrong and irrelevant".[77] But the FCA is itself wrong about this for the reasons explained above, and insofar as this is the basis on which it has refused to pay adequate regard to subvention, it misdirected itself. The FCA's "one size fits all" approach is also disproportionate, certainly so far as captive lenders are concerned. The FCA accepts (as is obvious) that it could have designed the Schemes differently, so as at least to attempt to reflect (if only in broad terms) the significant differences between different segments of the market.[78] Its refusal to do so seems to rest on the assertion that anything other than its own proposals would *ipso facto* be unworkable,[79] but this is obviously incorrect.

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obtained by consumers under the wider terms of the transaction was taken despite apparent internal acknowledgement that "The question of how any commission fed into the wider offerings package (including things like service agreements) is likely to be highly relevant to quantifying harm" ([FCA00000500] at p.3).

76 See, in relation to VWFS's agreements, [29] of the witness statement of Alexander Young, which explains that over £1.5 billion of subvention was provided under non-DCA agreements to VWFS customers during the 2017-21 period used for the FCA's DCA/non-DCA analysis, compared with only £58 million of subvention provided under DCA agreements. Further, Mr Young explains in [31]-[35] of his statement that the Schemes' failure to control for the uneven distribution of APR subvention between DCA and non-DCA loans (which is a feature of captive financing such as that provided by VWFS) means that the Schemes' 17% and 21% APR adjustments are likely to be materially overstated in their application to VWFS's agreements.

77 FCA Grounds, [173.4].

78 E.g. FCA Grounds, [166], [168].

79 FCA Grounds, [162].

83. For the reasons given above, the Scheme rules on redress should be quashed irrespective of the Tribunal's conclusions on the other grounds of VWFS's Application.

Richard Handyside KC

Jason Pobjoy KC

David Murray

Thomas Evans

Joseph Farmer

28 August 2026