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Case No: CR-2017-006681

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
INSOLVENCY AND COMPANIES LIST (CH)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 06/02/2019

Before :

THE HONOURABLE MR JUSTICE NORRIS

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Between :

IN THE MATTER of PRITCHARD STOCKBROKERS LIMITED (In Special Administration)
AND IN THE MATTER of the INVESTMENT BANK SPECIAL ADMINISTRATION REGULATIONS 201

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Mr Glen Davis QC (instructed by **Foot Anstey LLP**) for the Company and for the Special Administrators

Hearing dates: 25 January 2019

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Approved Judgment

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

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THE HONOURABLE MR JUSTICE NORRIS

Mr Justice Norris :

1. Pritchard Stockbrokers Ltd ("PSL") offered a full range of investment services from its Bournemouth headquarters and through a branch network throughout England and Wales. It was regulated by the Financial Services Authority ("FSA") and subsequently by the Financial Conduct Authority ("FCA"). The regulatory regime with which PSL had to comply included the Client Assets Sourcebook ("CASS").

2. At the relevant date in February 2012 CASS 7.7.1 G recorded that

> "Section 139(1) of the [Financial Services and Markets Act 2000 ("FSMA")]… creates a fiduciary relationship between the firm and its client under which client money is in the legal ownership of the firm but remains in the beneficial ownership of the client."

3. CASS 7.7.2 R then went on to provide (so far as material) :-

> "A firm receives and holds client money as trustee…..on the following terms:
>
> (1) for the purposes of and on the terms of the client money rules and the client money distribution rules;
>
> (2) … for the clients….. for whom that money is held, according to their respective interests in it;
>
> (3) ….
>
> (4) on the failure of the firm, for the payment of the costs properly attributable to the distribution of the client money in accordance with (2); and
>
> (4) after all valid claims and costs under (2) to (4) have been met, for the firm itself."

These are the primary terms of the statutory trust created under section 139(1) of FSMA in relation to client money held by PSL. (I say they are "the primary terms" because they are capable of being modified).

4. On 10 February 2012 the FCA issued a Supervisory Notice in respect of PSL because of its financial circumstances: directors of PSL had used client monies to pay business expenses. The Supervisory Notice meant (a) that PSL could not thereafter carry out any of its regulated activities (save to close out then-current transactions); and (b) that the client money distribution rules were triggered (the objective of which is to facilitate the timely return of client money to a client in the event of the failure of a firm).

5. The client money distribution rules referred to in the statutory trust are found in CASS 7A. This chapter provides that the service of the Supervisory Notice should constitute "a Primary Pooling Event" occurring at that date. The consequence of such an Event occurring was (under CASS 7A.24 R) that the client money held by PSL was treated as pooled and that the individual entitlement of any given client to specific funds was replaced by a claim on the pooled fund: whereupon the firm became subject to an obligation to distribute that pooled client money fund in accordance with CASS 7.7.2 R "so that each client receives a sum which is rateable to that client's money entitlement

calculated in accordance with CASS 7A.2.5R". (Although CASS 7A has been revised from time to time these words are a constant feature).

6. The service of the Supervisory Notice meant that PSL could no longer trade. It sold its client assets under management, including stock held for clients and customer contracts, but it did not transfer the client money pool of which it was trustee; and its directors then applied for (and on 9 March 2012 obtained from HHJ Jarman QC in the Cardiff District Registry) an investment bank special administration order. The Investment Bank Special Administration Regulations 2011 ("IBSA") constitute a "standalone" code which incorporates specified paragraphs of Schedule B1 to the Insolvency Act 1986. Joint special administrators were appointed.

7. Regulation 10(1) of IBSA provides that:-

> "The administrator has three special administration objectives;-
>
> (a) Objective 1 is to ensure the return of client assets as soon as is reasonably practicable;
>
> (b) Objective 2 is to ensure timely engagement with market infrastructure bodies and the Authorities …; and
>
> (c) Objective 3 is to either (i) rescue the investment bank as a going concern, or (ii) wind it up in the best interests of the creditors."

8. The commencement of this insolvency process did not put an end to or modify the statutory trust of the client money pool (which then was to ensure that each client received from the pooled fund a sum which was rateable to that client's money entitlement). The appointment of joint special administrators did not make *them* trustees of the statutory trust. PSL remained the trustee, and the power of managing PSL (so that it complied with its duties as trustee and executed the statutory trust) vested in the joint special administrators. Objective 1 required them to exercise those management powers so as to cause PSL to perform the statutory trust and return client money as soon as reasonably practicable.

9. So far as is possible, all client stock held by PSL or its nominee has been transferred to alternative stockholders for the clients. That leaves client money, being the uninvested balances on active accounts and residual balances on dormant accounts.

10. The client money pool comprised £23.5 million (to which some £350,000 of interest has accrued). The special administrators have taken steps to assess the client money entitlement of each client (of whom there were about 11,000) according to the books, documents and records of PSL, and to trace those clients. On 27 April 2012 the special administrators wrote to all known clients of PSL inviting claims and informing them of the establishment of a dedicated portal on the special administrators' website. In May 2012 advertisements were placed in the Gazette and in "The Times" seeking claims. On 17 July 2012 claim forms were issued to all clients of whose claims the special administrators were aware from PSL's books and records. Excepted from that. circulation of claim forms was a small number of clients whose claims it was known could not be formulated at that time: and they received claim forms later. The need for

clients to agree their claims in order for them to be able to share in the client money pool was repeated in each progress report. In February 2014 further letters were sent to those clients who had still not submitted or agreed claims: and that exercise was repeated in April 2014.

11. In March 2014 the special administrators embarked upon a proactive tracing process, claims with a potential value below £50 being treated in one way ("a "mini trace") and claims above £50 being treated in another ("a full trace"). A "mini trace" was a search of various databases and datasets seeking matches for information held about each client by PSL. Each "mini trace" cost £3. A "full trace" was an in-depth manual, complete investigation of the known details of the client using multi-layered data sources, including making telephone enquiries and sending personalised letters, and an investigation of the probate details of deceased clients. Each "full trace" cost £24.60 (with an additional £48 for probate traces). If any trace of either type produced different contact details from those held by PSL, then a letter was sent using those new details and indicating the special administrators' estimate of the value of the claim and details of the claims process. The tracing of clients was addressed in each of the progress reports of the special administrators (published on their dedicated portal): the August 2017 report canvassed the proposal to introduce a "bar date" to bring matters to a conclusion.

12. Through these processes by September 2018 claims of 6356 clients with a total value of £25,753,673 had been agreed. In addition the claims of a further 2387 clients had been agreed at a nil value. These agreed claims constitute 78% by number and 97% by value of potential claims on the client money pool. But it leaves 2463 clients with potential claims (having a possible value of £810,862.94) against that fund which have not been agreed. IBSA, as it applies to PSL, contains no applicable machinery for resolving these possible claims and so executing the statutory trust to ensure that each client received from the pooled fund a sum which was rateable to that client money entitlement. A final distribution cannot be made until these claims are resolved. By this application PSL and the joint special administrators seek the approval of the Court to a means of discharging the statutory trust which will exonerate PSL from committing a breach of trust and will protect the special administrators from any charge of procuring or participating in a breach of trust.

13. The problem of administering a trust where the beneficial interests in the fund cannot be ascertained with certainty is not new. The Court

> "if satisfied that every reasonable step had been taken in an attempt to trace individuals entitled to the fund, and that it was most improbable that any individual would ever establish a title" (per Russell LJ in Re Lowe's WT [1973] 1 WLR 882 at 887)

will exercise it supervisory jurisdiction over the administration of trusts to enable the trust property to be distributed according to practical probabilities. The Court will permit the administration of the fund "on the footing" that entitlement is confined to known members.

14. This is the "Re Benjamin order" which is well established in the sphere of private trusts, and is of equal utility in the context of "commercial trusts". For example, in Capita ATL Pension Trustees Limited v Gellately [2011] Pen LR 153 Henderson J (as he then

was) made a declaration that the trustees of a pension scheme were permitted to administer it on the basis that the only members of a particular class were those listed in the schedule to the order.

15. David Richards J (as he then was) applied the principles underlying the Re Benjamin [1902] Ch 723 jurisdiction to the very difficulties relating to final distributions under the CASS rules in Re MF Global UK Ltd (No 3) [2013] 1 WLR 3874. He summarised the order being sought in these terms:-

> "The order for which the administrators apply, and to which the client money distribution procedure is scheduled, provides that if the administrators give notice of intention to make a distribution, they shall be at liberty to proceed with the distribution on the basis that, first, the only persons with a claim to client money are those who have lodged a claim by the last date for making claims specified in the notice of distribution and, secondly, that any claim which has been rejected is not to be treated as a claim to client money, unless the claimant has given notice of application to the court to vary or reverse the rejection. The order further provides that if the administrators act in accordance with these provisions, neither MFG UK nor the administrators shall have any liability with respect to a distribution to any client who subsequently establishes its claim. The order does not purport to vary the beneficial interests of any client and, accordingly, provides that the exclusion of any claimant from such a distribution is without prejudice to their right to participate in any subsequent distribution from the client money trust, if they duly establish their claim, and is also without prejudice to any tracing or similar remedy that might be available to them."

He recognised that insofar as such an order affected known claimants whose claims had been rejected or otherwise not been resolved by agreement, the proposed order did not neatly fit within the Re Benjamin line of cases: but he held that that did not mean that the proposed order fell outside the proper scope of the inherent jurisdiction of the court.

16. The judge made the order sought (which I will call "an MF Global order"), explaining his reasons thus:-

> "The purpose of the Court's inherent jurisdiction is to enable practical effect to be given to a trust….. The purpose of the client money trust established by the CASS rules and the purpose of the client money distribution rules in CASS 7A is to protect the position of clients and to facilitate the timely return of client money in the event of the failure of the firm. These purposes are not well served by long delays while at considerable expense claims, which have been made but not pursued, are finally determined through court proceedings. If those persons who have made claims are seriously concerned to pursue them, it will be open to them under the administrators' proposals to lodge an application with the court, in which event full provision will be

> made for their claims while they are litigated. In my judgment these proposals properly balance both the interest of established clients to a timely return of their money and the interests of persons with serious but unresolved claims to be treated as clients."

17. The approach embodied in an MF Global order was also adopted by Birss J in Re Worldspreads Limited [2015] EWHC 1719, the order in which specifically preserved the right of a client

> ".. To pursue a claim, if any such claim is otherwise available to them (without acknowledging any such claim), to follow or trace and claim against Clients in receipt of any part of the relevant distribution from the Client Money Trust made prior to the agreement or establishment of their claim."

Likewise in Allenfield Property Insurance Services v Aviva Insurance Limited [2015] EWHC 3721 HHJ Keyser QC was asked to approve a scheme of distribution that would give a proper opportunity to all potential claimants against the statutory trust, but would then permit distribution of the fund in circumstances of imperfect knowledge without the extinguishment or modification of any existing beneficial interests.

18. But another approach has emerged. It is embodied in an Order of Newey J (as he then was) in Re Alpari (dated 29 September 2016). I will call it "an Alpari order". No copy of the judge's reasons for his order is available. This approach *varies* the statutory trusts so as to extinguish the beneficial interests of non-claiming beneficiaries. The "Alpari order" contemplates a final distribution of the pooled fund without regard to the client money entitlement of any client (a) who has not submitted a claim by a specified "bar date" (even when shown in the company's records to have an entitlement) or (b) whose claim is below a specified threshold, provided that certain conditions are met (and subject to a power vested in the trustee to admit late claims). The "Alpari order" specifically provides that a non-responsive client or a client with a minimal entitlement

> "shall cease to have an interest in client money within the meaning of CASS 7.17.2R(2) upon the final distribution of client money in the Client Money Trust in accordance with [the varied trust]."

This is the approach sought to be adopted in the present case.

19. Provided that PSL executes the modified statutory trust there can be no question of any breach of trust (or of complicity in any breach of trust on the part of the joint administrators) so far as the *distributions* are concerned. The protection that PSL (as trustee) requires and the protection that the joint administrators (who procure PSL to discharge its duties as trustee) require is in relation to the modification of the statutory trust of client money so as to exclude certain beneficiaries.

20. The client money rules in CASS 7 and the client money distribution rules in CASS 7A were made by the FCA under Part 9A of FSMA. Section 138A of FSMA provides that the FCA may, on the application or with the consent of the person subject to those rules,

> "…direct that all or any of those rules… (b) are to apply to that person with such modifications as may be specified in the direction."

21. On 26 September 2017 PSL acting by its joint administrators submitted an application to the FCA seeking the modification the CASS 7A client money distribution rules. I have already recounted the steps taken to trace all clients and to secure the agreement of their client money entitlements. As I have noted there remain approximately 2463 clients whose claims have not been agreed. The special administrators estimate that 1839 of these clients have claims of £1 or less; that a further 245 have claims of £10 less; that a further 183 have claims of £100 or less; that a further 111 clients have claims of £1000 pounds or less; and those with claims over £1000 number 86 (with one claim amounting to a substantial £43,767). The application to the FCA led to detailed correspondence as to how these claims might be addressed.

22. The structure to which the FCA has agreed is (in summary):

    (a) the introduction of a "bar date" and its gazetting and advertisement;

    (b) the specification of a *de minimis* threshold fixed by reference to the cost of making a distribution being £6.10 per claim (below which a client will have proactively to seek payment or be disregarded);

    (c) the contacting of all remaining known clients using the last known contact details with a yet further invitation to claim;

    (d) the making of a final distribution according to known claims above the threshold;

    (e) the notification to all "barred" clients of the existence of the FSCS and the provision of information as to the means of making a compensation claim;

    (f) the payment into the Insolvency Services Unclaimed Dividends Account of any agreed but uncollected claim or any unpresented cheque (and the giving of notice of that arrangement).

23. The structure is given effect by means of a direction given by the FCA under s.138A of FSMA on 16 April 2018, whereby CASS 7A.2.4R(2) (as set out in the then-current version applicable to PSL, being that in force on 25 July 2017) is modified by the insertion of additional provisions which alter the statutory trusts. For example, there is inserted a new rule (2A) which provides that:-

> "The firm may, in a final distribution of client money comprising the notional pool, make that distribution without regard to the client money entitlement of a client that has neither agreed its client money entitlement nor submitted a client money claim to

> the firm but is shown in the firm's records (as at the time of the distribution) as having a client money entitlement provided that the firm takes the following course of action…"

Or again a new rule (2C) which provides:

> "Upon the final distribution of client money comprising the notional pool…. a client referred to in (2A)… ceases to have an interest in client money within the meaning of CASS 7.17.2R(2) "

24. PSL does not need permission to distribute on this basis because these are the new statutory trusts which it is bound to perform. But the joint administrators may properly seek the directions of the court as to whether they should participate in the implementation of the new trusts (thereby obtaining approval of their causing PSL to seek a modification of the statutory trusts and protection in the implementation).

25. An application for directions under paragraph 63 of Schedule B1 is the appropriate vehicle. Where an insolvent company is a trustee, how the company should discharge its duties as trustee and execute the trusts upon which it holds property, and how it should avoid the generation of claims for breach of trust which would lie against its assets, are key questions to be addressed by the administrator: and he or she can properly seek directions as to how to perform their function in that regard. In the case of a special administrator to whom IBSA applies guidance on how to achieve Objective 1 is plainly appropriate.

26. In providing guidance to the administrator the Court will always be concerned to see

    (a) the exact nature and scale of the problem facing the special administrators in relation to a final distribution by the trustee company of the client money it holds on trust;

    (b) the precise steps which the joint administrators have caused the company to take in order to identify clients and quantify individual claims, and what the results are;

    (c) that every reasonable step has been taken to effect a distribution to each of those entitled having regard to (i) the size of the claim (ii) the cost and difficulty of investigation (iii) where that cost burden falls and (iv) the need to ensure the return of client assets to all clients as soon as reasonably practicable (so that a distribution notwithstanding imperfect knowledge is the appropriate course);

    (d) the details of the proposed distribution mechanism and what steps are to be taken in relation to those who will not receive a distribution;

    (e) if the statutory trusts are to be modified, then why the extinguishment of beneficial interests is to be preferred

over a distribution on a particular footing which preserves those beneficial interests (i.e. why an "Alpari order" is to be preferred over an "MF Global order").

27. All this was well addressed on the present application in careful evidence, and at the hearing I was satisfied that I should make the order sought. The one matter on which further comment is perhaps warranted is that noted in paragraph 26(e).

28. Special administrators have the choice of seeking permission for the trustee company to administer the existing trusts in a practical way without disturbing the beneficial interests, or of procuring the trustee company to seek a modification of the existing trusts to alter those beneficial interests. The latter is achieved simply by executive act of the regulator. If (for their protection) special administrators seek the directions of the Court then they should put before the Court sufficient material to explain their choice and to enable the Court in effect to sanction it by giving them permission to implement it.

29. The objective of the special administration process is the return of client assets as soon as is practicable. The process in the instant case has lasted more than 6 years. By a careful strategy the process has reduced the potential claimants to an unresponsive 22% rump with claims to only 3% of the client money pool. Many of the outstanding individual claims are so small that the view may properly be taken that the unpursued claims are abandoned. In relation to claims of more substance the view may properly be taken that the need for finality is much greater than the need to preserve hitherto unpursued claims. Those who now receive a *final* distribution are entitled to regard it as their own (and not exposed to some claim to follow or trace into it by a hitherto unresponsive client). It is undoubtedly time for the book to be closed.

30. It was for these reasons that at the hearing I approved the draft order.