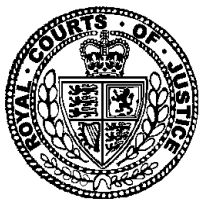

Neutral Citation Number: [2022] EWHC 402 (Ch)

Case No: CR-2019-004876

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
INSOLVENCY AND COMPANIES LIST (ChD)
IN THE MATTER OF ALLIED WALLET LIMITED

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

AND IN THE MATTER OF THE FINANCIAL SERVICES ACT 2000

AND IN THE MATTER OF THE ELECTRONIC MONEY REGULATIONS 2011

AND IN THE MATTER OF THE PAYMENT SERVICES REGULATIONS 2017

Royal Courts of Justice

The Rolls Building

London, EC4A 1NL

Date: 24/02/2022

Before :

INSOLVENCY AND COMPANIES COURT JUDGE BURTON

- -

SHANE CROOKS, EMMA SAYERS and MALCOLM COHEN (as Joint Liquidators of Allied Wallet Limited)

- -

Richard Fisher QC and Andrew Shaw (instructed by **Eversheds Sutherlands (International) LLP**) for the **Applicants**

Dr Riz Mokal for the **Financial Conduct Authority**

Hearing date:14 April 2021

- -

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.

This judgment was handed down remotely by circulation to those parties who appeared before the court by email. It will also be released for publication on BAILII and other websites. The date and time of hand-down is deemed to be 2.30pm on 24 February 2022

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Insolvency and Companies Court Judge Burton :

Introduction

1.
Shane Crooks, Emma Sayers and Malcolm Cohen, as joint liquidators of Allied Wallet Limited (the "Liquidators" and "AWL" respectively) have sought the Court's directions pursuant to section 168(3) of the Insolvency Act 1986 and/or the Court's inherent jurisdiction, regarding the interpretation and operation of the Payment Services Regulations 2017 ("PSR") and the Electronic Money Regulations 2011 ("EMR") (together, the "Regulations").

2.
Both of the Regulations required AWL, in the conduct of its business:

i)
processing electronic payments; and

ii)
issuing electronic money in the form of pre-paid cards,

to safeguard customer monies either by segregating them or by putting in place insurance or guarantee arrangements to the value of the relevant funds held. The safeguarding method that AWL purported to operate was that of segregating funds.

3.
The Liquidators' investigations have revealed significant breaches of the safeguarding obligations, missing and conflicting information regarding sums due to customers and almost certainly a shortfall of assets to meet the claims of customers and creditors, albeit currently in amounts which are impossible to calculate.

4.
They seek directions in relation to four key issues focussing primarily on whether, and if so on what terms and when, a trust may have arisen in respect of monies held by AWL on the date on which it was wound up.

5.
The Financial Conduct Authority ("FCA") declined to be a respondent to the application but as it is vested with statutory functions pursuant to the PSR and EMR, and is the regulator and supervisor of

authorised payment institutions, it intervened in the application in order to draw to the Court's attention, principles that it considers relevant to the questions underlying the Liquidators' application.

6.
The Liquidators assisted the Court by setting out the competing arguments which could be raised on each of the issues which it is asked to determine.

7.
I have been assisted by comprehensive argument from Mr Fisher QC, Mr Shaw and Dr Mokal.

Background

8.
There was no dispute regarding the circumstances giving rise to the Liquidators' application. As the issues before the Court concern statutory interpretation, I shall summarise the background only briefly.

9.
AWL was incorporated on 31 May 2006. Until 14 March 2018, its shareholders were Mr Khawaja and Allied Wallet Inc. ("AWI"), a company incorporated in Nevada. AWI transferred its shares in AWL to Mr Khawaja, who has been its sole shareholder since 14 March 2018 and sole director at the date of its incorporation and at the date of winding up (with two other individuals having been appointed and resigned at various times in-between).

10.
AWL facilitated electronic payments for online businesses (the "Merchant Business") and provided electronic money to customers in the form of pre-paid cards (the "Prepaid Card Business"). These aspects of its business were regulated by the FCA. AWL was also involved in developing and maintaining a payment processing gateway. That part of its business was not regulated.

11.
In carrying out the Merchant Business, AWL was subject to the PSR. AWL was registered with the FCA for the purposes of the Payment Services Regulations 2009 as a "small payments institution" from 1 November 2009 until 20 September 2012 and as an "authorised payments institution" thereafter until 3 February 2014, when its registration was cancelled by the FCA.

12.
In carrying out the Prepaid Card Business, AWL was authorised since 3 February 2014 by the FCA as an "authorised electronic money institution" and subject to the EMR. Where appropriate or convenient I shall refer to companies engaged in such businesses as an "Institution".

13.
It has subsequently transpired that AWL was conducting activities outside its authorisation under the EMR.

14.
The FCA became concerned, among other issues, that AWL was mixing monies that should be segregated pursuant to the EMR or the PSR, with its own funds. On 22 July 2019, the FCA presented a winding-up petition against AWL (the "Petition") under s.367 of the Financial Services and Markets Act 2000 ("FSMA 2000"). On the same date, it applied for the appointment of provisional liquidators.

Its application was granted on 23 August 2019 by Snowden J (as he was), who appointed the Liquidators as joint provisional liquidators and directed them to report on a number of matters, including whether:

“all “Relevant Funds” for the purposes of each of the Electronic Money Regulations and the Payment Services Regulations are available for return to customers, the location of any such Funds, and if relevant, the reasons why any such Funds are not available”.

15.
On 10 September 2019, the Liquidators (as joint provisional liquidators) applied for the Court’s directions in relation to paragraph 5 of Snowden J’s order, which provided that:

“The Provisional Liquidators shall permit the Company’s director to draw on the Company’s assets, which for the avoidance of doubt do not for this purpose include the Relevant Funds, to meet the reasonable costs of obtaining legal advice and legal representation in relation to [the director’s application for an administration order and AWL’s application for the release of funds]”.

16.
Mr Khawaja withdrew his application for an administration order shortly before the hearing of the Petition.

17.
The joint provisional liquidators’ application for the release of funds was heard by Mr John Kimbell QC (sitting as a deputy High Court judge) on 18 December 2019. It became clear at the hearing that the FCA and Mr Khawaja had a fundamental difference of opinion regarding the effect of the Regulations. The FCA contended that monies segregated (and those which should have been segregated) pursuant to the Regulations are subject to a trust that extends to the traceable proceeds of any payments received; whereas Mr Khawaja’s position was that the protection is more limited, being purely contractual or statutory in nature and as such did not give rise to any proprietary rights in favour of AWL’s customers. Mr Kimbell QC was not invited to resolve this issue at the time, but he acknowledged that it was likely to require resolution in due course.

18.
A winding-up order was made against AWL on 20 March 2020 The Applicants, then joint provisional liquidators were appointed as joint liquidators on 26 March 2020.

AWL’s Merchant Business

19.
In facilitating card payments for online businesses, AWL would stand between the card issuer (for example, Mastercard or Visa) and a merchant, and would facilitate the transfer of funds from the card issuer to the merchant. AWL had a direct relationship with some merchants (“Direct Merchants”) but also processed payments for merchants who were customers of a company incorporated in Lithuania, UAB Baltic Bill, for which AWL had agreed to provide settlement services (“Indirect Merchants”). AWL was obliged under the PSR to safeguard moneys received from merchants or card issuers.

20.
The Liquidators provided evidence of the conflicting and confusing information they have received regarding the amounts owed to AWL’s Direct and Indirect Merchants. Upon their initial appointment as joint provisional liquidators, they were provided by AWL’s employees with schedules showing that £104,210 was owed to 22 Direct Merchants and £5,898,491 was owed to 77 Indirect Merchants.

Subsequent information suggested that AWL had 820 merchant customers to which it owed £16,699,855. Later still, it was suggested by information held by a third party on behalf of AWL, that 27 merchants who had already lodged claims with the Liquidators for an amount in excess of £9 million were in fact debtors, owing AWL approximately £5.6 million.

21.
At the date of the hearing, the Liquidators had received claims from 57 merchant customers with a total value of £21,271,630. If admitted, the value of these claims would significantly exceed the total assets currently known to be available to meet them. The Liquidators consider that they may ultimately face insurmountable difficulties obtaining reliable information regarding the sums properly due to AWL's creditors in respect of the Merchant Business.

The Prepaid Card Business

22.
AWL provided corporate customers with cards issued by Mastercard. Those customers would either pay funds that corresponded to sums to be loaded onto cards, or pay lump sums to AWL that would be loaded onto cards at some future date.

23.
AWL was provided with support in operating the Prepaid Card Business by Carta Financial Services Limited ("Carta").

24.
The EMR obliged AWL to safeguard the moneys it received from customers for loading onto pre-paid cards. AWL operated segregated accounts with Lloyds Bank in relation to the Prepaid Card Business. Upon receipt of funds into these accounts from a corporate customer, AWL would notify Carta of the amounts to be credited to the relevant prepaid cards. AWL would then transfer equivalent funds to accounts held in the name of Mastercard (the "MC Settlement Accounts").

25.
The Liquidators have learned that AWL would ordinarily settle prepaid card liabilities incurred to Mastercard on the same day, and that the MC Settlement Accounts were intended to contain sufficient funds to act as a buffer in the event that a prepaid card customer incurred charges at a time when AWL's bank was closed, for example over a weekend. However, it appears that AWL in fact placed sufficient sums in the MC Settlement Accounts to meet all cardholder liabilities.

26.
Carta has provided the Liquidators with information showing that AWL had 4,459 individual cardholders to whom it owes a total amount of £654,504. Against this, at the date of the application, the Liquidators had received claims from only 16 cardholders, amounting to £153,224. The information provided by Carta indicates that the same 16 cardholders are only owed £102,383 by AWL.

27.
Two corporate customers have asserted claims in relation to funds paid to AWL which were not loaded onto prepaid cards, in one case for more than €690,000 and in the other for more than US$600,000. One of these customers has made an additional claim exceeding US$200,000 for moneys that were loaded onto prepaid cards that can no longer be accessed.

AWL's assets

28.
The Liquidators have identified 55 bank accounts operated by or on behalf of AWL in 16 different currencies. Of these, only 4 appear to have been operated as safeguarding accounts in which segregated funds could be held in accordance with the Regulations. Each is an account held with Lloyds Bank used in the operation of the Prepaid Card Business ("Lloyds Safeguarding Accounts").

29.
There are a further 15 accounts which AWL designated internally as "Receipt of Client Processing monies and payment of received processed funds to merchants" (the "Internally Designated Accounts"). However, contrary to the requirements of the Regulations, the relevant banks had not been notified or required to acknowledge that these 15 accounts were safeguarding accounts.

30.
As at 15 December 2020, the total cash balances held by AWL (converted to GBP where appropriate) were:

i)
£362,928 held in Lloyds Safeguarding Accounts;

ii)
£6,892,761 held in Internally Designated Accounts;

iii)
£2,086,138 held in accounts which appear to the Liquidators to be used to hold AWL's own funds; and

iv)
£2,068,744 held as collateral by Mastercard, Visa and UnionPay (the bulk of which has been returned to the Liquidators).

31.
In addition, AWL appeared to be entitled to the following sums:

i)
£666,370 held in MC Settlement Accounts;

ii)
£109,224 from a third party debtor (which has since been received);

iii)
a potential tax refund (although the Liquidators are unable, at present, to provide the requisite information to realise it); and

iv)
approximately $4.3m from various debtors all of which are not identified other than AWI which is no longer trading and which apparently owes AWL approximately £4.2m.

32.
Save in relation to the Internally Designated Accounts and the Lloyds Safeguarding Accounts, the Liquidators are currently unable to establish which, if any, of the other sums that AWL holds (or to which it is entitled) constitute monies that ought to have been subject to safeguarding requirements.

The issues before the Court

33.
Both the EMR and the PSR provide that on an insolvency event, “relevant funds” that have been segregated in accordance with the safeguarding provisions form an “asset pool” that is then distributed to “electronic money holders” and “payment service users” respectively, in priority to other creditors, less only the costs of distributing the asset pool. The difficulty that arises is that neither of the Regulations provides (i) what assets should comprise the asset pool in circumstances where there has been a failure by an Institution to comply with the Regulations’ safeguarding provisions; nor (ii) how claims to the asset pool should be ascertained.

34.
The Liquidators have sought the Court’s directions on the following five issues:

i)
Do the EMR and the PSR create a trust of relevant funds upon their receipt by AWL?

ii)
If they do, which assets are subject to such a trust or form part of the asset pool, and what obligations (if any) do the Liquidators have to comply with to reconstitute the asset pool?

iii)
How are claims against assets subject to such a trust or contained within the asset pool to be ascertained, and how should such assets be distributed?

iv)
What costs are properly considered to be “costs of distributing the asset pool” for the purposes of regulation 24 of the EMR and regulation 23 of the PSR?

v)
If the EMR or the PSR do not create a trust of the relevant funds, how should the asset pool arising under those provisions on the insolvency of AWL be applied in the event of a shortfall against claims made?

35.
The effect of the PSR was considered in Re Supercapital Ltd[2020] EWHC 1685 (Ch), where Deputy ICC Judge Agnello held that a statutory trust arose in relation to the relevant funds. However, the Deputy ICC Judge did not have the benefit of adversarial argument and the decision does not encompass all of the issues facing the Liquidators of AWL in relation to the proper application of both of the Regulations.

The Court’s jurisdiction to determine the issues before it

36.
Section 168(3) of the Insolvency Act 1986 provides that in cases in which a company is being wound up by the Court, the liquidator may apply to the Court “for directions in relation to any particular matter arising in the winding up”.

37.
Mr Fisher QC drew my attention to various cases where the Court has been prepared to give directions to office holders of companies which acted as trustees of client funds, and the office holders were seeking directions in relation to the proposed entering into of distribution plans. Whilst the cases support the contention that section 168(3) and equivalent provisions concerning administration

do not limit the scope of an office-holder's directions application to matters concerning the assets of the company, he nevertheless highlighted that it is not always clear from the judgments, whether the directions are given pursuant to section 168 (or its equivalent in administration (paragraph 63 of Schedule B1 to the Insolvency Act 1986 – an administrator may apply to the Court for directions "in connection with his functions")) or under the Court's inherent equitable jurisdiction.

38.
Each of the cases to which I was referred:

i)
Allanfield Property Insurance Services Ltd [2015] EWHC 3721 (Ch) which itself cited Re Worldspreads Ltd [2015] EWHC 1719 (Ch);

ii)
Re Pritchard Stockbrokers Ltd [2019] EWHC 137 (Ch); and

iii)
Hunt v Financial Conduct Authority [2019] EWHC 2018 (Ch)

included circumstances where it was known and accepted that the relevant regulations created a trust and the insolvency office holder was seeking the Court's directions in relation to assets which clearly did not belong beneficially to the insolvent company.

39.
Recognising, as these cases variously do, that:

i)
the Court has an inherent jurisdiction to give directions to trustees to distribute trust property in a particular manner when the Court considers it expedient to do so; and

ii)
where an insolvent company is a trustee, a key question to be addressed by its administrators, and in respect of which they may seek the Court's directions under paragraph 63 of Schedule B1, is how the company should discharge its duties as trustee,

the cases have variously decided that the Court has jurisdiction to give such directions under paragraph 63 of Schedule B1, or under its inherent jurisdiction or, as determined by HHJ Keyser in Worldspreads Ltd:

"In my view it suffices to say that when seised of an application under paragraph 63, the court may in a proper case exercise the inherent equitable jurisdiction".

40.
In this case, the first issue for the Court to determine is whether a trust arises or not. Issues 1 and 4 of the Liquidators' application seek directions in relation to the correct interpretation of the Regulations. Issues 2, 3 and 5 seek directions, in light of that interpretation, as to how claims to assets that appear currently to be subject to the company's control, should be ascertained, and how the assets should be distributed.

41.
In my judgment, Issues 1 and 4 can be characterised as "matters arising in the winding up" and subject to the Court's directions under section 168(3). If the Court finds that relevant funds are

subject to a statutory trust, adopting the approach taken by HHJ Keyser in Allanfield, it would then be for the Court, within the context of the section 168(3) directions application, to exercise its inherent equitable jurisdiction and give directions in relation to the trust. If the Court concludes that the monies are not held on trust, directions can be given under section 168(3) in the usual way in relation to assets of the company.

The relevant legislative provisions

Safeguarding provisions in the EMR

42.
Regulation 20(1) of the EMR provides:

“Electronic money institutions must safeguard funds received in exchange for electronic money that has been issued (referred to in this regulation and regulations 21 and 22 as “relevant funds”)”

43.
“Electronic money” is defined at regulation 2 of the EMR as:

“electronically (including magnetically) stored monetary value as represented by a claim on the electronic money issuer which—

(a) is issued on receipt of funds for the purpose of making payment transactions;

(b) is accepted by a person other than the electronic money issuer; and

(c) is not excluded by regulation 3.”

The exclusions referred to at (c) are not relevant to the issues before the Court.

44.
Regulation 20(2) of the EMR provides that safeguarding must be conducted in accordance with regulations 21 and 22.

45.
Regulation 20(3) provides:

“Where

(a) only a proportion of the funds that have been received are to be used for the execution of a payment transaction (with the remainder being used for non-payment services); and

(b) the precise portion attributable to the execution of the payment transaction is variable or unknown in advance, the relevant funds are such amount as may be reasonably estimated, on the basis of historical data and to the satisfaction of the Authority, to be representative of the portion attributable to the execution of the payment transaction.”

46.
The Safeguarding Options are set out in Regulations 21 and 22:

“Safeguarding Option 1

(1) An electronic money institution must keep relevant funds segregated from any other funds that it holds.

(2) Where the institution continues to hold the relevant funds at the end of the business day following the day on which they were received it must—

(a) place them in a separate account that it holds with an authorised credit institution or the Bank of England; or

(b) invest the relevant funds in secure, liquid, low-risk assets ("relevant assets") and place those assets in a separate account with an authorised custodian.

(3) An account in which relevant funds or relevant assets are placed under paragraph (2) must—

(a) be designated in such a way as to show that it is an account which is held for the purpose of safeguarding relevant funds or relevant assets in accordance with this regulation; and

(b) be used only for holding those funds or assets, or for holding those funds or assets together with proceeds of an insurance policy or guarantee held in accordance with regulation 22(1)(b).

(4) No person other than the electronic money institution may have any interest in or right over the relevant funds or the relevant assets placed in an account in accordance with paragraph (2)(a) or (b) except as provided by this regulation.

…

(Regulation 21(5) imposes an obligation to keep records in respect of funds segregated pursuant to regulation 21.)

Regulation 22:

"Safeguarding Option 2

(1) An electronic money institution must ensure that—

(a) any relevant funds are covered by—

(i) an insurance policy with an authorised insurer;

(ii) a comparable guarantee from an authorised insurer; or

(iii) a comparable guarantee from an authorised credit institution; and

(b) the proceeds of any such insurance policy or guarantee are payable upon an insolvency event into a separate account held by the electronic money institution which must—

(i) be designated in such a way as to show that it is an account which is held for the purpose of safeguarding relevant funds in accordance with this regulation; and

(ii) be used only for holding such proceeds, or for holding those proceeds together with funds or assets held in accordance with regulation 21(3).

(2) No person other than the electronic money institution may have any interest or right over the proceeds placed in an account in accordance with paragraph (1)(b) except as provided by this regulation…"

47.

Regulation 24 of the EMR addresses the insolvency of an electronic money institution that issued electronic money:

EMRRegulation 24 – Insolvency Events

“(1) Subject to paragraph (2), where there is an insolvency event—

(a) the claims of electronic money holders are to be paid from the asset pool in priority to all other creditors; and

(b) until all the claims of electronic money holders have been paid, no right of set-off or security right may be exercised in respect of the asset pool except to the extent that the right of set-off relates to fees and expenses in relation to operating an account held in accordance with regulation 21(2)(a) or (b) or (4A), or 22(1)(b).

(2) The claims referred to in paragraph (1)(a) shall not be subject to the priority of expenses of an insolvency proceeding except in respect of the costs of distributing the asset pool.

(3) An electronic money institution must maintain organisational arrangements sufficient to minimise the risk of the loss or diminution of relevant funds or relevant assets through fraud, misuse, negligence or poor administration.

(4) In this regulation—

“asset pool” means—

(a) any relevant funds segregated in accordance with regulation 21(1);

(b) any relevant funds held in an account accordance with regulation 21(2)(a);

(ba) where regulation 21(4A) applies, any funds that are received into the account held at the Bank of England upon settlement in respect of transfer orders that have been entered into the designated system on behalf of electronic money holders, whether settlement occurs before or after the insolvency event;

(c) any relevant assets held in an account in accordance with regulation 21(2)(b);

(d) any proceeds of an insurance policy or guarantee held in an account in accordance with regulation 22(1)(b).”

Safeguarding provisions in the PSR

48.
Regulation 23 of the PSR provides:

“(1) For the purposes of this regulation “relevant funds” comprise the following—

(a) sums received from, or for the benefit of, a payment service user for the execution of a payment transaction; and

(b) sums received from a payment service provider for the execution of a payment transaction on behalf of a payment service user.

…

(3) An authorised payment institution must safeguard relevant funds in accordance with either—

(a) paragraphs (5) to (11); or

(b) paragraphs (12) and (13).

…

(5) An authorised payment institution must keep relevant funds segregated from any other funds that it holds.

(6) Where the authorised payment institution continues to hold the relevant funds at the end of the business day following the day on which they were received it must—

(a) place them in a separate account that it holds with an authorised credit institution or the Bank of England; or

(b) invest the relevant funds in such secure, liquid assets as the FCA may approve ("relevant assets") and place those assets in a separate account with an authorised custodian.

(7) An account in which relevant funds or relevant assets are placed under paragraph (6) must—

(a) be designated in such a way as to show that it is an account which is held for the purpose of safeguarding relevant funds or relevant assets in accordance with this regulation; and

(b) be used only for holding those funds or assets, or for holding those funds or assets

together with proceeds of an insurance policy or guarantee held in accordance with paragraph (12)(b).

(8) No person other than the authorised payment institution may have any interest in or right over the relevant funds or relevant assets placed in an account in accordance with paragraph (6)(a) or (b) except as provided by this regulation.

…

(11) The authorised payment institution must keep a record of—

(a) any relevant funds segregated in accordance with paragraph (5);

(b) any relevant funds placed in an account in accordance with paragraph (6)(a);

(c) any relevant assets placed in an account in accordance with paragraph (6)(b);

…

(12) The authorised payment institution must ensure that—

(a) any relevant funds are covered by—

(i) an insurance policy with an authorised insurer;

(ii) a comparable guarantee given by an authorised insurer; or

(iii) a comparable guarantee given by an authorised credit institution; and

(b) the proceeds of any such insurance policy or guarantee are payable upon an insolvency event into a separate account held by the authorised payment institution which must—

(i) be designated in such a way as to show that it is an account which is held for the purpose of safeguarding relevant funds in accordance with this regulation; and

(ii) be used only for holding such proceeds, or for holding those proceeds together with funds or assets held in accordance with paragraph (7).

(13) No person other than the authorised payment institution may have any interest in or right over the proceeds placed in an account in accordance with paragraph (12)(b) except as provided by this regulation.

(14) Subject to paragraph (15), where there is an insolvency event—

(a) the claims of payment service users are to be paid from the asset pool in priority to all other creditors; and

(b) until all the claims of payment service users have been paid, no right of set-off or security right may be exercised in respect of the asset pool except to the extent that the right of set-off relates to fees and expenses in relation to operating an account held in accordance with paragraph (6)(a) or (b), (9) or (12)(b).

(15) The claims referred to in paragraph (14)(a) shall not be subject to the priority of expenses of an insolvency proceeding except in respect of the costs of distributing the asset pool.

…

(18) In this regulation—

“asset pool” means—

(a) any relevant funds segregated in accordance with paragraph (5);

(b) any relevant funds held in an account in accordance with paragraph (6)(a);

(c) where paragraph (9) applies, any funds that are received into the account held at the Bank of England upon settlement in respect of transfer orders that have been entered into the designated system on behalf of payment service users, whether settlement occurs before or after the insolvency event;

(d) any relevant assets held in an account in accordance with paragraph (6)(b); and

(e) any proceeds of an insurance policy or guarantee held in an account in accordance with paragraph (12)(b)”

Issue 1 – Does a statutory trust arise under the Regulations?

A statutory obligation to create contractual rights?

49.
At the hearing before HHJ Kimbell QC, Mr Khawaja contended that the EMR’s safeguarding requirements protect customers by giving their claims priority over the claims of other unsecured creditors. Rather than expressly referring to the creation or imposition of a trust, the EMR possess the following characteristics that suggest, instead, a statutory obligation to create contractual rights:

i)
The EMR refer to an electronic money holder having a “claim” on the electronic money institution. Regulation 2(1) of the EMR defines “electronic money” as:

“electronically (including magnetically) stored monetary value as represented by a claim on the electronic money issuer which (a) is issued on receipt of funds for the purpose of making payment transactions; (b) is accepted by a person other than the electronic money issuer; and (c) is not excluded by regulation 3” (my emphasis);

ii)
Regulations 24(1)(b) and 24(4) of the EMR permit an electronic money institution to grant security over the asset pool. This appears to be inconsistent with any suggestion that electronic money holders have a proprietary interest in the pool;

iii)
Regulation 39 of the EMR provides for the electronic money institution, upon receipt of funds and without delay, to issue electronic money at par value, and, upon request of the electronic holder, to “redeem” the monetary value of the electronic money. Such language is consistent with the institution exchanging funds received for electronic money and upon doing so, being bound by a contractual right to repay the financial obligation;

iv)
Regulations 40 to 43 address the conditions for redemption, including at regulation 43, provision for the electronic money issuer not being required to comply with a redemption request which is made “more than six years after the date of termination of the contract”. A claim to recover trust property is not subject to a limitation period;

v)
The ability, under the EMR, for an electronic money institution to satisfy its safeguarding obligations by taking out insurance is also inconsistent with a customer having a proprietary interest in the funds upon the issuer’s receipt;

vi)
The language of regulation 20(3) of the EMR, referring in particular to the electronic money holder estimating the amount considered to be representative of the portion attributable to the execution of the payment transaction, is inconsistent with a customer having a proprietary right to the relevant funds; and

vii)
Regulation 72 provides that a contravention of the safeguarding obligation “is actionable at the suit of a private person who suffers loss as a result of the contravention, subject to defences and other incidents applying to actions for breach of statutory duty”. No consideration is given to customers having proprietary claims.

50.
Due to their common origin and similar wording, substantially the same arguments may be made in relation to the PSR. Viewed in isolation, these submissions create a persuasive argument. Where then, are the indicia relied upon by the FCA, that notwithstanding these provisions and the absence of express wording, the Regulations should be interpreted to create a statutory trust of the relevant funds?

Interpreting the provisions of the EMR and PSR

51.
The safeguarding provisions of the PSR and EMR arise as part of Parliament's intention to give effect, in English law to the relevant EU directives (the "Directives").

52.
They have a common origin and, as demonstrated, are drafted in materially identical terms. The EMR implemented what is colloquially described as 2EMD or the Second Electronic Money Directive 2009/110/EC. 2EMD was complementary to the Payment Services Directive 2007/64/EC of the European Parliament and of the Council (the "Payment Services Directive"). Article 7 of 2EMD provides that Member States shall require electronic money institutions to safeguard funds that have been received in exchange for electronic money issued in accordance with Article 9 of the Payment Services Directive.

53.
Article 9 of the Payment Services Directive provided:

"Article 9 - Safeguarding requirements

1. The Member States or competent authorities shall require a payment institution which provides any of the payment services listed in the Annex and, at the same time, is engaged in other business activities referred to in Article 16(1)(c) to safeguard funds which have been received from the payment service users or through another payment service provider for the execution of payment transactions, as follows:

either:

(a)		they shall not be commingled at any time with the funds of any natural or legal person other than payment service users on whose behalf the funds are held and, where they are still held by the payment institution and not yet delivered to the payee or transferred to another payment service provider by the end of the business day following the day when the funds have been received, they shall be deposited in a separate account in a credit institution or invested in secure, liquid low-risk assets as defined by the competent authorities of the home Member State; and
(b)		they shall be insulated in accordance with national law in the interest of the payment service users against the claims of other creditors of the payment institution, in particular in the event of insolvency; or
(c)		they shall be covered by an insurance policy or some other comparable guarantee from an insurance company or a credit institution, which does not belong to the same group as the payment institution itself, for an amount equivalent to that which would have been segregated in the absence of the insurance policy or other comparable guarantee, payable in the event that the payment institution is unable to meet its financial obligations.

2. Where a payment institution is required to safeguard funds under paragraph 1 and a portion of those funds is to be used for future payment transactions with the remaining amount to be used for

non-payment services, that portion of the funds to be used for future payment transactions shall also be subject to the requirements under paragraph 1. Where that portion is variable or unknown in advance, Member States may allow payment institutions to apply this paragraph on the basis of a representative portion assumed to be used for payment services provided such a representative portion can be reasonably estimated on the basis of historical data to the satisfaction of the competent authorities.

3. The Member States or competent authorities may require that payment institutions which are not engaged in other business activities referred to in Article 16(1)(c) shall also comply with the safeguarding requirements under paragraph 1 of this Article.

4. The Member States or competent authorities may also limit such safeguarding requirements to funds of those payment service users whose funds individually exceed a threshold of EUR 600."

54.
The Payment Services Directive was implemented in the UK by the Payment Services Regulations 2009. The Payment Services Directive was replaced on 25 November 2015 by Directive (EU) 2015/2366 of the European Parliament and of the Council ("PSDII"). PSDII was implemented in the UK by the PSR, which, save for certain exceptions, took effect from 13 January 2018.

55.
Article 10 of PSDII sets out the required safeguarding provisions. Its terms are very similar to those specified by Article 9 of the Payment Services Directive:

"Article 10 - Safeguarding requirements

1. The Member States or competent authorities shall require a payment institution which provides payment services as referred to in points (1) to (6) of Annex I to safeguard all funds which have been received from the payment service users or through another payment service provider for the execution of payment transactions, in either of the following ways:

(a)	funds shall not be commingled at any time with the funds of any natural or legal person other than payment service users on whose behalf the funds are held and, where they are still held by the payment institution and not yet delivered to the payee or transferred to another payment service provider by the end of the business day following the day when the funds have been received, they shall be deposited in a separate account in a credit institution or invested in secure, liquid low-risk assets as defined by the competent authorities of the home Member State; and they shall be insulated in accordance with national law in the interest of the payment service users against the claims of other creditors of the payment institution, in particular in the event of insolvency;
(b)	funds shall be covered by an insurance policy or some other comparable guarantee from an insurance company or a credit institution, which does not belong to the same group as the payment institution itself, for an amount equivalent to that which would have been segregated in the absence of the insurance policy or other comparable guarantee, payable in the event that the payment institution is unable to meet its financial obligations.

2. Where a payment institution is required to safeguard funds under paragraph 1 and a portion of those funds is to be used for future payment transactions with the remaining amount to be used for non-payment services, that portion of the funds to be used for future payment transactions shall also

be subject to the requirements of paragraph 1. Where that portion is variable or not known in advance, Member States shall allow payment institutions to apply this paragraph on the basis of a representative portion assumed to be used for payment services provided such a representative portion can be reasonably estimated on the basis of historical data to the satisfaction of the competent authorities."

56.
Dr Mokal submitted, and I accept, that the effect of the UK leaving the European Union is as follows: having been made pursuant to section 2(2) of the European Communities Act 1972, the Regulations comprise "EU-derived domestic legislation" under section 1B(7) of the European Union (Withdrawal) Act 2018 (the "2018 Withdrawal Act"). Pursuant to section 2(1) of the 2018 Withdrawal Act, both Regulations continue to have effect in domestic law. No provisions having been made pursuant to section 5A of the 2018 Withdrawal Act (for the extent to which, or circumstances in which, a relevant court is not to be bound by retained EU case law), section 6(3)(a) continues to apply to the laws of England and Wales:

"Any question as to the … meaning or effect of any retained EU law is to be decided, … so far as they are relevant to it … in accordance with any retained case law and any retained general principles of EU law."

57.
Consequently, the decision of the European Court of Justice in Marleasing SA v La Comercial Internacional de Alimentacion SA C-106/89 [1990] ECR I-4135, is retained case law and the so-called "Marleasing principle" is a retained principle:

"the Member-States' obligation arising from a Directive to achieve the result envisaged by the Directive and their duty under Article 5 EEC to take all appropriate measures, whether general or particular, to ensure the fulfilment of that obligation, is binding on all the authorities of member-States including, for matters within their jurisdiction, the courts.

It follows that, in applying national law, whether the provisions in question were adopted before or after the Directive, the national court called upon to interpret it is required to do so, as far as possible, in light of the wording and the purpose of the Directive in order to achieve the result pursued by the latter…"

58.
For the same reasons, the principles set out by Briggs J (as he was) at first instance and approved by Lord Dyson at paragraph 131 of his judgment in the Supreme Court in relation to interpretation of the relevant EU directives implemented by CASS7 in Lehman Brothers International (Europe) (in administration) v CRCCredit Fund Ltd ("Lehman v CRC") [2012] 1 BCLC 487continue to apply:

i)
the first stage involves interpreting the Directives;

ii)
the second stage involves interpreting the UK implementing legislation in the light of the meaning of the Directives and in accordance with the following principles:

a)
the court should not be constrained by conventional rules of construction;

b)
construction does not require that the UK statutory language be ambiguous;

c)
it is not an exercise in semantics or linguistics;

d)
departure from strict and literal application of the words which the legislative has elected to use is permitted;

e)
the implication of words necessary to comply with Community Law is permissible; and

f)
the precise form of words to be implied does not matter.

59.
Lady Justice Arden helpfully summarised the task at paragraph 58 of her judgment in the same case before the Court of Appeal ([2011] 2 BCLC 184). She referred to the Sourcebook rules being the subject of extensive consultation by the FCA and the need for any interpretation to be "grounded in reality". More generally in relation to construction of the rules, at paragraph 58 she said:

"the court must bear in mind the overall scheme of the rules and keep in proportion any drafting infelicities. Since the rules are designed to protect investors (see FSMA section 138(1), set out above), the court should lean against interpretations which result in legal "black holes". The court has to at least start out with the view that the drafter intended to create a coherent scheme, even if this is ultimately disproved in certain respects".

The first stage: interpreting the Directives

60.
Section 6(3) of the European Union Withdrawal Act 2018 expressly provides that any question regarding the meaning or effect of unmodified, retained EU law is to be decided in accordance with retained general principles of EU law.

61.
Recitals to EU laws are not legally binding. However, as confirmed in Casa Flesichhandel v Bundesantalte fur Landswirtschafliche Marktordnung [1989] ECR 2789 (ECJ) (which concerned interpretation of a Regulation but reflects a well-known principle of EU law) where an EU law is ambiguous, the recitals can be important in interpreting the ambiguous provision. If the recitals are inconsistent with the operative text of the Directive or Regulation, the operative provision will take precedence.

62.
The first recital of the Payment Services Directive notes that it is essential for the establishment of the internal market that barriers within the European Community are dismantled to enable the free movement of goods, persons, services and capital, for which, the proper operation of a single market in payment services is vital.

63.
The eleventh recital notes:

“The conditions for granting and maintaining authorisation as payment institutions should include prudential requirements proportionate to the operational and financial risks faced by such bodies in the course of their business. In this connection, there is a need for a sound regime of initial capital combined with ongoing capital which could be elaborated in a more sophisticated way in due course depending on the needs of the market.

Due to the range of variety in the payments services area, this Directive should allow various methods combined with a certain range of supervisory discretion to ensure that the same risks are treated the same way for all payment service providers.

The requirements for the payment institutions should reflect the fact that payment institutions engage in more specialised and limited activities, thus generating risks that are narrower and easier to monitor and control than those that arise across the broader spectrum of activities of credit institutions. In particular, payment institutions should be prohibited from accepting deposits from users and permitted to use funds received from users only for rendering payment services. Provision should be made for client funds to be kept separate from the payment institution's funds for other business activities. Payment institutions should also be made subject to effective anti-money laundering and anti-terrorist financing requirements.”

64.
The Payment Services Directive, from which both the EMR and PSR derive, thus drew a clear line between credit institutions whose business it is to accept deposits and that are permitted, against stringent capital adequacy requirements, to use customers’ funds for their own purposes, and Institutions, that are prohibited from doing either.

65.
The same principles were repeated in PSDII, the thirty-fourth recital of which explained that there was no intention substantially to alter the conditions for granting and maintaining authorisation as a payment institution. Article 18(5) of PSDII expressly prohibits payment institutions from “taking deposits or other repayable funds” and 18(3) provides that any money received by a payment institution with a view to the provision of payment services “shall not constitute a deposit or other repayable funds”.

66.
Articles 6(2) and (3) of 2EMD similarly expressly prohibit electronic money institutions from taking deposits or other repayable funds from the public and provide that any funds received must be converted to electronic money without delay and will not constitute either a deposit or repayable funds.

67.
The fourth recital to 2EMD states that it was enacted:

“With the objective of removing barriers to market entry and facilitating the taking up and pursuit of the business of electronic money issuance, the rules to which electronic money institutions are subject need to be reviewed so as to ensure a level playing field for all payment services providers.”

68.
The concept of a level playing field is reflected in both the eighth and the fourteenth recitals. The eighth explains that 2EMD was intended to align the regulatory regime to which electronic money issuers were to be subject with those to which payment services institutions were subject under the

PSD. The fourteenth draws comparisons with credit institutions and provides that the level playing field should be achieved by:

“balancing the less cumbersome features of the prudential supervisory regime applying to electronic money institutions against provisions that are more stringent than those applying to credit institutions, notably as regards the safeguarding of the funds of an electronic money holder. Given the crucial importance of safeguarding, it is necessary that the competent authorities be informed in advance of any material change, such as a change in the safeguarding method, a change in the credit institution where safeguarded funds are deposited, or a change in the insurance undertaking or credit institution which insured or guaranteed the safeguarded funds.”

69.
Thus the Directives continued to maintain a clear distinction between credit institutions which are able to take deposits and then apply money so received for their own purposes, and Institutions that may neither take deposits nor apply customers’ money for their own purposes.

70.
Whilst credit institutions are subject to extensive regulation and in particular, capital adequacy requirements, the Directives provide for customers’ monies held by Institutions to be safeguarded instead. Recital 37 of PSDII provides:

“Provision should be made for payment service user funds to be kept separate from the payment institution’s funds. Safeguarding requirements are necessary when a payment institution is in possession of payment service user funds. Where the same payment institution executes a payment transaction for both the payer and the payee, and a credit line is provided to the payer, it might be appropriate to safeguard the funds in favour of the payee once they represent the payee’s claim towards the payment institution…”

71.
In my judgment, it is clear from the recitals set out above that among the stated purposes of the Directives is a requirement to ensure that Institutions are obliged to keep customer monies separate from their own funds and that such customer monies cannot be used for other business activities.

The second stage: interpreting the UK implementing legislation in the light of the meaning of the Directives

72.
The Directives were to operate across all of the EU Member States, some of which do not recognise the concept of a trust. EU directives can be transposed into UK law either with minimum additions or changes (described as the “copying-out” approach) or the wording of the directive can be elaborated. Elaboration carries with it the perceived risk of potentially over-implementing EU law and/or potentially creating unnecessary regulation and burden on UK businesses - commonly referred to as “gold-plating”. The Government’s consultation document inviting views on the proposed steps to implement PSD2: “Implementation of the revised EU Payment Services Directive II” (February 2017) explained that the Government’s proposed approach, “consistent with its general approach to implementation of EU legislation” would be to “copy-out wherever possible”.

73.
This, in my judgment, provides a likely explanation why the word “trust” is not used in the Regulations.

74.
The Directives prohibit Institutions from using funds received from users for their own purposes. The fact that a financial institution cannot use the money in its own business was noted by Lord Collins at paragraph 189 of the judgment in the Supreme Court in Lehman v CRC as the “essential characteristic” of a trust. He stated, in relation to a statutory trust and by reference to Lord Diplock in Ayerst (Inspector of Taxes) v C&K (Construction) Ltd [1976] AC 167, that:

“… all that might be meant by the use of the word ‘trust’ was giving property the essential characteristic which distinguishes trust property from other property; namely, it cannot be used or disposed of by the legal owner for his own benefit but must be used or disposed of for the benefit of others”.

75.
Regulations 21(1) of the EMR and 23(5) of the PSR require relevant funds to be segregated from other funds held by the receiving entity. The reference to relevant funds for these purposes identifies the specific assets which are to be the subject of the safeguarding regime.

76.
Where relevant funds continue to be held following the close of business on the day after they were received, they must either be kept in a separate and identified bank account with the Bank of England or an authorised credit institution or invested in low-risk assets which are to be held separately by an authorised custodian (regulation 21(2) of the EMR and regulation 23(6) of the PSR).

77.
The receiving entity must keep records of relevant funds that have been segregated or invested in low-risk assets (regulation 21(5) of the EMR and regulation 23(11) of the PSR). In my judgment these measures are inconsistent with a debtor-creditor relationship where the receiving entity would be entitled to use the funds it receives in the course of its business.

78.
Any account holding relevant funds (or the relevant assets in which relevant funds have been invested) must be designated as holding funds for the purpose of safeguarding (regulations 21(1) and (2) of the EMR and regulations 23(12) and (13) of the PSR). Any account in which relevant funds or assets are held must be used only for safeguarding purposes (regulation 31(3)(b)EMR, regulation 23(7)(b)PSR). No person other than the receiving entity may have an interest or right in funds which have been segregated (regulation 21(4) of the EMR and regulation 23(8) of the PSR).

79.
On the occurrence of an “insolvency event” the safeguarded moneys form an asset pool that is to be paid to “electronic money holders” (in the case of the EMR) or “payment service users” (in the case of the PSR) in priority to claims of other creditors, and “no right of set-off or security right may be exercised in respect of the asset pool…” (regulation 24(1)EMR and regulation 23(14) of the PSR).

80.
Claims paid from the asset pool shall not be subject to the priority of expenses of an insolvency proceeding except in respect of the costs of distributing the asset pool (regulation 24(2) of the EMR and regulation 23(15) of the PSR). In my judgment, this is a strong indicator that the asset pool is to be kept separate from the Institution’s general pool of assets and that the safeguarded moneys were not to be at the free disposal of the Institution. This, in itself indicates that there was no intention to

vest in the Institution, the beneficial interest in moneys provided by its customers. Those moneys are to be kept separate and available for the customers who provided them.

81.
In my judgment, taking into account all the regulations I have set out above, I am satisfied that the EMR and the PSR each create a statutory trust of relevant funds. All the essential characteristics of an English law trust are present (see Ayerst (Inspector of Taxes v C& K (Construction) Ltd).

82.
Mr Khawaja referred to the words used in regulations 43 and 48 and 91 and 92 of the PSR to demonstrate that the relationship between the payment service institution and the payment service user was contractual in nature. Regulation 48 refers to the framework contract set out in Schedule 4. In my judgment it is not inconsistent with an electronic money or payment service institution acting in two capacities: first as the provider of contractual services and secondly, within that role, acting as trustee of monies it receives and holds on behalf of its customers pending and during the provision of such services.

83.
Another factor said to be inconsistent with the creation of a statutory trust was the implication, as seen for example in regulations 23 and 24(4) of the EMR (regulation 23(14) and 23(18) of the PSR) that the Institution can grant security over the asset pool. There is, as far as I am aware, no express provision contemplating or regulating the creation of such security. Regulation 23(14) provides that where there is an insolvency event:

“until all claims of payment service users have been paid, no right of set-off or security right may be exercised in respect of the asset pool …” (my emphasis).

Regulation 23(18) defines “security right” to mean:

“(a) security for a debt owed by an authorised payment institution or a small payment institution and includes any charge, lien, mortgage or other security over the asset pool or any part of the asset pool; and

(b) any charges arising in respect of the expenses of a voluntary arrangement”.

84.
Where, as I have held, relevant funds are to be held on trust, in my judgment, the references to security in these regulations and the references to “other creditors” in regulations 23 of the PSR and 24 of the EMR should, insofar as inconsistent with that conclusion, be disregarded as “infelicities” of drafting.

Issue 2 – What assets are subject to the trust and form part of the asset pool?

85.
In approaching this question, the first question for the Court to determine is when the statutory trust arises.

When does the statutory trust arise?

86.
As the key to interpretation of EU-derived domestic legislation lies in its European origins, I start again with the relevant Directives and a reminder of Recital 37 of PSDII which provides:

“Provision should be made for payment service user funds to be kept separate from the payment institution’s funds. Safeguarding requirements are necessary when a payment institution is in possession of payment service user funds.” (my emphasis).

87.
Article 7 of 2EMD provides:

“Member States shall require an electronic money institution to safeguard funds that have been received in exchange for electronic money that has been issued, in accordance with Article 9(1) and (2) of Directive 2007/64/EC. Funds received in the form of payment by payment instrument need not be safeguarded until they are credited to the electronic money institution’s payment account or are otherwise made available to the electronic money institution in accordance with the execution time requirements laid down in the Directive 2007/64/EC, where applicable. In any event, such funds shall be safeguarded by no later than five business days, as defined in point 27 of Article 4 of that Directive, after the issuance of electronic money.”

88.
In finding that the EMR and PSR create a statutory trust, I relied upon the recitals to 2EMD and PSDII. Recital 37 of PSDII provides:

“Provision should be made for payment service user funds to be kept separate from the payment institution’s funds. Safeguarding requirements are necessary when a payment institution is in possession of payment service user funds.”

89.
Whilst the Directives fail to specify whensuch funds must be segregated, the purpose is clear: once the institution is in receipt of electronic money customers’ and payment services users’ funds, they are obliged to protect them. It would be contrary to this purpose if the protection only arises and applies when – or if - the relevant Institution complies with its safeguarding obligations.

90.
The Regulations similarly omit any express provision regarding timing. Regulation 20 of the EMR provides that the institution:

“.. must safeguard funds that have been received in exchange for electronic money that has been issued (referred to in this regulation and regulations 21 and 22 as “relevant funds”)”.

and where Option 1, segregation is pursued, regulation 21 simply provides that the institution:

“must keep relevant funds segregated from any other funds that it holds”.

91.
The reference to “funds that have been received in exchange for electronic money that has been issued” suggests a ‘backwards’ interpretation of “relevant funds”: that it is only after the institution has performed its part of the contract and issued the electronic money, that the customer’s money is protected. Such an interpretation would only make sense if the institution operated a ‘pay on delivery’ model. I do not understand that to have been the case. When interpreting EU-derived legislation, the implication of words to comply with the Community law is permissible. In my judgment, to comply with the purpose and meaning of 2EMD, it is necessary to imply words into regulation 20 of the EMR to the effect that the funds in question are those paid to itfor the issue of electronic money.

92.

In my judgment, it follows that where the chosen method of safeguarding is segregation, to create an effective safeguarding arrangement, the obligation to safeguard, and the creation of the statutory trust, must arise on receipt of funds.

93.
Regulation 23(1) of the PMR defines “relevant funds”:

“(a) sums received from, or for the benefit of, a payment service user for the execution of a payment transaction”.

94.
This provision appears, more clearly than those in the EMR, to refer to monies paid to the institution for the prospective provision of services. Such relevant funds must be segregated and, in my judgment and for the same reasons set out above in relation to the PMR, the obligation to safeguard by segregation, and the creation of the statutory trust, arises concurrently and bites immediately upon the Institution’s receipt of the customer’s money.

The scope of the “asset pool”

95.
I have been reluctant until now to refer to the Supreme Court’s decision in Lehman v CRC other than for the purposes of establishing the principles to be applied when interpreting EU-derived domestic legislation. Notwithstanding Lehman Brothers International (Europe)’s failure “on a truly spectacular scale”, like AWL, to comply with the requirements for safeguarding client money, it held client money under CASS7 which, unlike the EMR and PSR, expressly imposed a statutory trust when a firm “receives and holds” client money.

96.
The second issue before the Supreme Court was nevertheless very similar to this court’s consideration of the scope of the “asset pool”: whether the client money pool (“CMP”) provided for by CASS7 applied to money that was identifiable as client money in LBIE’s “house accounts” or only to money that had in fact been segregated. Their Lordships noted that this issue was closely connected with the third issue before them, which they addressed first: whether the right to participate in the CMP was limited to those whose money had been identifiably segregated or whether it extended to those whose money ought to have been segregated, but was not.

97.
Whilst the Supreme Court unanimously upheld the decision of the Court of Appeal and of Briggs J at first instance that the statutory trust under CASS7 arose on receipt of client money (rather than when it was segregated) there was a difference in views as to who should be entitled to participate in the CMP. The majority did not consider it “quite unrealistic”, as Lord Walker did, to conclude that all customers whose funds ought to have been segregated should be entitled to participate in the asset pool. The majority considered that the CMP should include all identifiable client money whether held by the firm in a segregated account or in a “house account”.

98.
I similarly contemplated whether it might be more helpful first to consider who should be entitled to share in the “asset pool” before returning to determine the scope of that pool. However an examination of the terms of the EMR and PSR suggest that should not be necessary and that if I were to do so, there might be a danger, in this case, of letting the tail wag the dog.

99.
The EMR and PSR definitions of “asset pool” are set out at paragraphs 47 and 48 above and include “relevant funds” (which I have construed above) “segregated” or “held in an account” pursuant to regulations 21(2)(a) or 21(2)(b) 22(1)(b) of the EMR or 23(6)(a), 23(6)(b) of the PMR (or, in relation to proceeds of an insurance policy, regulations 22(1)(b) and 23(12)(b) of the EMR and PSR respectively). Notably, the past tense is deployed: “segregated” and “held”. A literal reading would result in only those funds that were in fact segregated, falling within the “asset pool”.

100.
The Regulations appear to be have been drafted with limited consideration to the very serious and complicated consequences that would be likely to flow from a failure to safeguard monies. Regulation 72 of the EMR and regulation 148 of the PSR simply provide that a contravention of the safeguarding requirements, options and insolvency provisions is:

“actionable at the suit of a private person who suffers loss as a result of the contravention, subject to the defences and other incidents applying to actions for breach of statutory duty”.

101.
As Mr Khawaja highlighted, there is no mention of a potential, proprietary claim. This argument would support a conclusion that the Regulations’ wording should be interpreted “as read” so that there is no need to construe the “asset pool” beyond those monies or assets that were, in fact, segregated.

102.
However, such a literal reading and construction would fly in the face of my decision that the EMR and PSR must be construed in a manner that promotes the purpose of the Directives. Having decided that the Regulations create a statutory trust that bites upon receipt of relevant funds, it would be wholly inconsistent, in the event of a breach of trust, to restrict the rights of beneficiaries under the statutory trust, to claims in the manner provided for at regulations 72 of the EMR and 148 of the PSR.

103.
At paragraph 166 of his judgment in Lehman v CRC, Lord Dyson underlined his approach to interpretation by reference to the Directive when considering the similar issues:

“There is the further point that, in view of the overriding purpose of the scheme, it is unlikely that client money which had yet to be segregated under the alternative approach was intended to be treated differently from client money which had been segregated, whether under the normal approach or the alternative approach.”

104.
As he also noted, when interpreting EU-derived legislation, the court may depart from a strict literal application of the words used and may imply words necessary to comply with Community law. In my judgment, additional words should be implied into each of regulation 24(4) of the EMR and regulation 23(18) of the PSR to enable them to be construed to include in the “asset pool” all funds that should have been safeguarded upon receipt by the institution.

Issue 3 – How should the asset pool be distributed?

105.
When deciding the issues which ultimately fell to the Supreme Court in Lehman v CRC, at first instance, Briggs J approached the question of who should be entitled to share in the CMP as a contest

between two theories which he identified as (i) the contributions theory, and (ii) the claims theory. The same approach is appropriate in this case. The Court must decide whether those entitled to claim a share of the asset pool comprise only those persons whose funds were properly safeguarded (the "contribution basis") or extend to include those whose funds should have been safeguarded but were not (the "claims basis").

106.
Regulation 24(1) of the EMR states that "the claims of electronic money holders are to be paid from the asset pool in priority to all other creditors". Regulation 23(14) of the PSR provides identical wording, replacing "electronic money holders" with "payment service users". This wording is consistent with my construction of the safeguarding provisions of the Regulations taking effect by the creation of a statutory trust of relevant funds upon receipt in favour of all those whose funds were in fact, and those that should have been, segregated

107.
Counsel referred me to Re Suco Gold Pty Ltd (1982) 33 SASR 99 where, at page 109, King CJ determined that whilst ultimately a matter of equity, where there proves to be a shortfall in a fund, the right of every beneficiary to participate in the fund, is fair and just so that each beneficiary claimant should take a proportion of the fund. In my judgment, and in light of the findings I have made, the only equitable method to distribute the asset pool is on a pari passu basis between all electronic money holders or all payment service users, as appropriate.

Issue 4 – The scope and costs of the work to be undertaken by the Liquidators

108.
The Court's finding that the Regulations gave rise to a statutory trust, creates scope for those beneficially entitled to assets held on trust to seek to trace their claims into misapplied assets. AWL is a defaulting trustee. As the Regulations fail expressly to provide for a trust, not surprisingly there are no express obligations upon any officeholder of AWL to take steps to reconstitute the relevant asset pools. As officers of the court with extensive powers under the Insolvency Act 1986 to obtain from third parties information regarding the company's business and affairs, substantial experience chasing assets, office and support infrastructure to communicate with creditors, review and re-visit strategies as information and facts emerge and now having spent a significant time already investigating AWL's business, in my judgment, the Liquidators are best placed to try to determine (i) the extent of beneficiaries' claims to the asset pools held on statutory trust; (ii) the destination of misapplied trust assets; and (iii) whether the actual and likely impediments to recovering misapplied assets would be likely to justify the costs of doing so.

109.
The absence of reliable information renders it inappropriate and unrealistic for this court to exercise its inherent jurisdiction by giving the Liquidators, as liquidators of AWL and qua trusteeof the statutory trusts any mandatory directions to investigate or recover assets. As noted above, their suitability for the role – acting at all times in the best interests of beneficiaries – arises, in my judgment, as a result of the very similar judgment calls they are required to make on a daily basis when administering insolvent estates. The key difference in this case (which is far from unusual in an insolvency arena) is that the Court has found the assets to be subject to a trust. I shall consider with counsel, on handing down this judgment, the appropriate form of order authorising the Liquidators to administer and seek to reconstitute the trusts, reserving discretion to them to determine what actions

and steps are in the best interests of the beneficiaries of the trust, with liberty to apply to court for such directions as they may choose to seek.

110.
The directions shall further provide, consistent with my finding in relation to Issue 3, that AWL acting by its Liquidators, qua trustee shall distribute the asset pools rateably, or pari passu between the beneficiaries under the statutory trusts.

111.
That leaves the question of costs. The Liquidators have been permitted, pending determination of the issues in this case, by orders of ICC Judge Jones, myself and ICC Judge Prentis to draw a percentage of their remuneration and all expenses incurred in investigating, ascertaining and collecting in relevant funds on an interim basis. Were it not for the note at the end of this judgment, in light of the matters set out in this judgment, the Court would proceed to make an order providing for the reasonable costs and expenses, reasonably incurred by the Liquidators in investigating, ascertaining and collecting in the relevant assets be treated as forming part of the costs of distributing the asset pools for the purpose of the EMR and PSR.

112.
The only remaining issue to be addressed concerns the date on which a customer's claim to the asset pool in a foreign currency might be treated as being converted to sterling. The two most likely dates for the Court to settle upon would be either the date on which the asset pool was formed which occurred on the "insolvency event" – i.e. the date on which the winding-up order was made, or (in practical terms, falling slightly short of) the date on which a proposed distribution is to be made.

113.
Counsel noted the significant practical and conceptual difficulties that arise with each approach. Similar issues exercised the courts and many lawyers for a considerable period of time in relation to currency conversion claims under the Insolvency Rules in the Lehman Waterfall litigation. Whilst the Court may wish to take the construction of those Rules arrived upon in the Waterfall litigation into account, the potential losses that might be suffered by some beneficiaries and potential windfall gains of others (depending on the date they would expect their claim to be calculated) led me to conclude that before reaching a decision on this vexed question, and again, before becoming aware of the judgment referred to in the note at the end of this judgment, I would have requested further submissions on whether any principles of trust law might be of application or assistance.

NOTE

(A)
In the time between hearing this application and circulating my draft judgment, David Halpern QC, sitting as a Deputy High Court Judge handed down his judgment in Re ipagoo LLP (in administration) [2021] EWHC 2163 (Ch). ipagoo was authorised to issue electronic money. Its administrators sought directions whether the EMR create a statutory trust of the "asset pool" and whether relevant funds which should have been, but were not dealt with in accordance with regulations 20 – 22 of the EMR form part of the asset pool.

(B)
The Judge concluded that no statutory trust arose under the EMR and that an office holder of an entity that had not properly safeguarded relevant funds would be obliged, under the terms of the

EMR, to override the usual priority rules that arise on insolvency and add to the asset pool, a sum equal to the amount of funds that should have been safeguarded, but were not.

(C)
The Judge's conclusions are clearly at odds with my own. As an Insolvency and Companies Court Judge, I am bound by a decision of a High Court Judge. It will be apparent from my detailed reasoning in this judgment that whilst the Judge's judgment does not address some of the issues put before the court in this case (in particular, the allocation of costs and quantification of foreign currency claims) those parts of my judgment that consider costs allocation are dependent on my finding that the EMR (and PSR) give rise to a statutory trust.

(D)
I understand that the FCA has applied for permission to appeal the Judge's order. I shall invite counsel, on handing down this judgment, which must now conclude with a finding that a statutory trust does not arise, to address me regarding what steps, if any, the Joint Liquidators now wish to take in relation to AWL.