Case Note [1]

Financial Conduct Authority v Avacade Limited (In Liquidation) & Others [2020] EWHC 1673 (Ch)

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I. Introduction

On 30 June 2020 Adam Johnson QC, sitting as a Deputy Judge of the High Court, handed down a detailed and lengthy judgment in *Financial Conduct Authority v Avacade Ltd (In Liquidation) & Ors*. The judgment finds various perimeter breaches by the two corporate defendants and concludes that their directors and senior managers were *"knowingly concerned"* therewith.

It is the latest in a developing line of case law concerning high-risk investments held in self-invested personal pensions ("SIPP(s)"). In that context it is of particular interest as the first decision directly concerning regulatory enforcement. The judgment also contains more general analysis of the meaning and scope of articles 25 and 53 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 ("RAO") and section 21 of the Financial Services and Markets Act 2000 ("FSMA"), which will be wider relevance to those acting in the regulated sector.

II. Background

Avacade concerns the regulatory implications of business models of Avacade Limited ("Avacade") and Alexandra Associations Limited ("AA"), both of which provided services to consumers to assist with the transfer of their existing pensions into investments held within SIPP wrappers. Avacade operated from 2010 to 2014, and AA substantively took over its operations from early 2015.

The judgment sets out the development and history of Avacade's business model in some detail. However, insofar as is relevant to the FCA's claim, it was as follows.

Customers were cold-called with a view to offering a free pension report. If they were happy to do so, letters of authority were signed enabling Avacade to obtain information from their existing pension provider. Upon receipt of the signed forms, a 'welcome call' was made to the customer and Avacade then made contact with the customer's existing pension fund. After production of a draft pension report, a 'pre-report call' was made to the customer to ask questions concerning their pension provision and retirement plans. A finalised pension report was then produced and sent to the client. It included four options from which the customer

[1] Nothing in this Case Note is intended as legal advice and should not be taken as such. It is produced for informational/educational purposes only.

could choose: (i) do nothing; (ii) transfer into a personal pension; (iii) transfer into a stakeholder pension; or (iv) transfer into a SIPP.

The report was followed by a further telephone call between Avacade and the customer, during which the four options set out in the report were discussed. Once documents were signed, customers then had the option to take advice from a third-party IFA. Thereafter, assuming the result was a transfer into a SIPP, Avacade again contacted the customer by telephone to discuss investment options. That was on the assumption that, since the investments were unregulated, any advice given was also outside the scope of article 53. Alternatively, if the investments to be included in the SIPP were regulated, Avacade's case was that it directed the customer to a third-party IFA for advice.

AA's business model, described by the Deputy Judge at [145]–[162], had much in common with Avacade's. Importantly, however, there was increased involvement throughout the process by a third-party IFA, 'BlackStar'.

In summary, the FCA's case was that both Avacade and AA's business models were designed to funnel customers towards pensions transfers into SIPPs and, thereafter, into unregulated investments from which they could earn the most commission. It was suggested that Avacade and AA committed perimeter breaches by conducting activities in the course of business which fell within article 25 (making arrangements, etc) and/or article 53 (advising) of the RAO. In addition, a separate allegation was made against AA only that it was conducting an article 53A activity (advising on pensions). Further, that they were making unauthorised financial promotions in breach of section 21 FSMA. As against, their individual directors, it was alleged that they were *"knowingly concerned"* in the contraventions as should likewise be subject to regulatory sanction.

III. Meaning and application of article 25 RAO

The FCA alleged perimeter breaches of article 25 RAO by Avacade and AA by reference to: (i) transferring out of existing pensions; (ii) transferring into a SIPP; (iii) divesting of cash in the SIPP; and (iv) purchasing one or more of the promoted investments. The court's view was that, in reality, there were two substantive stages to be considered: first, transferring from the existing pension into a SIPP and, secondly, then using those funds to purchase investments.

In relation to the scope of article 25(1) versus (2), the Deputy Judge considered that sub-article (2) was intended to be wider than (1). While the latter required the act in question to be directly causative of the transaction, sub-article (2) captured *"a more inchoate form of activity, which is not necessarily causative of the transaction… but which nonetheless helps it to happen"* (at [227(iii)]). Thus, the court endorsed the FCA's Handbook guidance on the provision at PERG 5.6.2 and 5.6.4. Moreover, the Deputy Judge considered it plain that dealing with only one party to the transaction would be sufficient to potentially bring arrangements within the scope of the provision (at [228]). To that extent, *Watersheds v Da Costa* [2009] EWHC 1299 (QB) at [69])(or, at least, the defendants' interpretation of it) was doubted.

In relation to articles 29 and 33, the Deputy Judge considered that they must be interpreted purposively in light of the intended *"safeguard"* built-in, i.e. to protect parties against difficulties which might arise *"when non-authorised persons stand to obtain a reward or pecuniary advantage from making arrangements."* As such, article 29 applies only where such rewards either come directly from the client or are account for to the client. Equally, article 33 provides a relevant safeguard by being more generous as to the scope of reward, but only in relation to specific types of introduction, i.e. to authorised or exempt persons for a particular purpose. The language of those provisions was therefore interpreted and applied accordingly, e.g. at [230(x)]).

The result was that the Deputy Judge concluded that it was *"inescapable"* that the business model and structures put in place by Avacade involved the making of arrangements for the purposes of article 25(2) RAO. As he noted, Avacade's primary intention was to earn commission from the unregulated investments placed within customers' SIPP wrappers following a pension transfer (e.g. see [234], [240] and [244]).

In relation to the application of the article 29 exclusion, it was argued by Avacade that it earned commissions only from the unregulated investments and, as such, receipt of those commissions was a function of the customer's decision. The Deputy Judge, however, disagreed. Apparently in agreement with the FCA's 2013 Alert,[2] he concluded that *"it is not possible… to treat as distinct the pensions transfer aspect and the investment decision"* for two reasons (at [248]). First, because the transfer into a SIPP was a means to an end for Avacade's purposes. Secondly, because information relevant to the investment decision was ascertained in the early stages of Avacade's process.

Equally, Mr Johnson QC was satisfied that the article 33 exclusion could not assist. Focussing on the phrase *"with a view to"*, he considered that the primary purpose of the introductions was for customers to seek legal advice. Rather, it was to *"bring about a situation in which the desired investments would be made and the commissions earned"* (at [253]). As such, he endorsed an *"objective"* approach to its application. Thus, the facts that customers had the option to take independent advice from third-party IFAs, and that SIPP administrators had some discretion to refuse customers' investments, did not assist with the application of article 33 since the availability of such advice could not alter the *"true purpose"* of the arrangements (e.g. at [266]-[267]). It is perhaps also noteworthy that, in this respect, a comparatively narrow interpretation of the Principle-based duties endorsed by Mr Justice Jacobs in *R (Berkeley Burke SIPP Administration Ltd) v Financial Ombudsman Service* [2018] EWHC 2878 (Admin) appears to have been taken (at [280]).

The same conclusions also applied in relation to AA's business model, for broadly the same reasons. See: [281]-[297].

[2] *"Advising on pensions transfers with a view to investing pension monies in unregulated products through a SIPP"*, 18 January 2013.

IV. Meaning and application of article 53 RAO

In relation to article 53, the FCA contended that Avacade/AA had given advice in the various telephone calls with customers both in relation to the draft and final pension report and investment decisions. These allegations were denied by the defendants, noting in particular that various of the call scripts deployed stated that no advice was to be provided.

It was agreed between the parties that the correct approach to the issue was as per *Thornbridge v Barclays* [2015] EWHC 3430 (QB), at [35], i.e. that an *"objective test"* must be applied. Thus, as per the guidance in the FCA's Handbook at PERG 8.28.4 and *Rubenstein v HSBC* [2011] EWHC 2304 (QB), at [81], the Court reiterated the distinction between a recommendation as to a course of action and the mere provision of facts and figures.

On that basis, the Deputy Judge began by rehearsing the detail of Avacade and AA's sales scripts and contractual terms (at [312]-[336]). In particular, the latter emphasised that the firms were not providing advice to customers as they were not authorised by the FCA to do so. Further, that all customers were recommended to seek suitable advice from qualified accountants, IFAs or solicitors before taking any investment decision.

Nonetheless, Mr Johnson QC concluded that Avacade and AA's processes – as reflected in the sales scripts – went beyond the provision of information (at [337] and [343]). Irrespective of the four options presented to the customer as available in theory (see above), the calls were intended to engage the customer's interest in transfer into a SIPP, followed by acquisition of investments which might generate an enhanced pension fund. Thus, he found it *"impossible to resist the conclusion"* that the process involved the *"expression of opinions or recommendations"* in two ways (at [340]). First, the customer may have been left with the impression that the agent was of the view that transferring into a SIPP was the best course to take. Secondly, as to the division of investments, which *"carried the implication"* that the agent considered it the best thing to do. Although allegations of advice had been recently rejected by HHJ Dight CBE in *Adams v Options SIPP* [2020] EWHC 1229 (Ch), the Deputy Judge considered that the facts were obviously distinguishable (at [342]).

From that starting point, the Deputy Judge proceeded to consider two further questions: (i) whether the conclusion was affected by Avacade and AA's contractual terms; and/or (ii) whether advice was given in relation to *"a particular investment"* as is required by regulation 53 RAO?

On the first question, a distinction was drawn between the imposition of an advisory duty at common law versus the application of article 53 RAO. In the former case, the scope of the party's duty as defined by the contractual documents would be relevant – even if a statement strayed into the territory of advice, liability could be effectively disclaimed (e.g. per *Thornbridge*, at [70]). However, the question for determination in the present case was simpler. Namely, *"whether exchanges with consumers took place which, on their proper construction, can be said to qualify as "advice" within the scope of the restriction on Art 53 RAO?"* (at [350(iv)]). That question reflected the function of article 53 RAO, i.e. to prevent those who were not qualified from expressing views which, in substance, constitute advice about the merits of a transaction.

Thereafter, on the second question, reference was made to Q19 in the guidance at PERG 12.3. It was submitted on behalf of Avacade and AA that certainly any statements at the earlier stages of the process could not relate to a *"particular investment"* since there was no SIPP in existence at that juncture. Again, however, the Deputy Judge rejected that contention on the basis that the investment did not yet have to be in existence, so long as a particular investment was in mind (at [353(i)]). In that regard, he noted that the defendants worked only with a limited number of SIPP providers with the default product, at least from 2011, being a Liberty SIPP operated by the Liberty Pension Scheme.

On that basis it was concluded that the defendants were therefore also giving unauthorised advice in contravention of article 53 RAO.

V. Meaning and application of section 21 FSMA

Having considered the defendants' breaches of the RAO, the court turned to consider whether they had breached the prohibition on financial promotions under section 21 FSMA. As a preliminary point, the Deputy Judge accepted, as per PERG 8.4.4, that the promotion must objectively seek to persuade or induce a person to engage in the investment in question (at [365]-[366]).

In support of its case in this regard, the FCA relied upon Avacade's website, certain investment brochures and the contents of the call scripts considered in relation to article 53. It argued that they were obviously promotional, not only in content but also from the surrounding context. Avacade/AA's position, however, was that they only ever provided information, save to the extent that they made available materials approved by authorised persons as permitted by section 21(2) FSMA.

Ultimately, the Deputy Judge had *"no doubt"* that Avacade and AA's websites, the investment handbooks and call scripts relied upon *"were intended to promote investment activity"* (at [369]). He cited various extracts and examples, as well as the general aim of the Avacade/AA busines models (see above), concluding that *"the overall picture seeks to encourage investment by means of a transfer into a SIPP"* (at [373]).

VI. "False or misleading" statements – Financial Services Act 2012, section 98

In addition, the court also considered the meaning and scope of section 98 of the Financial Services Act 2012.

That section provides that an offence is committed by any person who makes *"false or misleading"* statements, is reckless as to such statements, or *"dishonestly conceals material facts"* in connection with such a statement, for the purpose of inducing another, or being reckless to the fact that it may induce another, to enter into a relevant agreement or investment. A similar provision applied prior to 1 April 2013 by virtue of section 397 FSMA (now repealed), which was also cited and relied upon by the FCA.

The Deputy Judge considered that, insofar as the FCA's case relied upon statements made by employees of Avacade/AA who had gone 'off-script', there was the possibility – at least in theory – of imposing liability on the employer vicariously. That was because none of the statements relied upon went *"so far off script that it would be wrong in principle to regard them as having been made while acting in the ordinary course of the employee's employment"* (at [394]).

Nonetheless, the Deputy Judge concluded that the FCA's case in this regard must fail because of the particular way in which it had been advanced. It was not said that the employees who extemporised on the sales scripts had a dishonest intent which could be imported to the directing willing and mind of their employer. Rather it was alleged that the directing will and mind of Avacade/AA had the relevant state of mind thanks, directly, to the actions of their directors (at [399]).

Consequently, the FCA's case had to be limited the content of the agreed sales scripts themselves. That being so, the Deputy Judge rejected all but two aspects of the FCA's case. First, that it was *"false or misleading"* to say that customers were required to obtain independent advice in order to transfer their pensions into SIPPs (at [424] to [431]). Secondly, that Avacade/AA were reckless as to as to the truth of the statement that their investments had proven track records and were low risk (at [439] to [447]).

VII. "Knowingly concerned" – section 382 FSMA

As well as the corporate defendants, Avacade and AA, their individual directors were also defendants to the claim. In relation to the individual defendants, the question arose as to whether the court could make restitutionary orders against them under section 382(1) FSMA on the basis that they were *"knowingly concerned"* with the companies' contraventions.

In that respect, the Deputy Judge referred to the analysis of HHJ McCahill in *FCA v Capital Alternatives* [2018] 3 WLUK 623 at [797] to [810]. Thus, although a variety of persons and roles may be *"concerned"*, passive knowledge is not sufficient; there must be *"actual involvement"* in the contravention.

It was submitted on behalf of the individuals that they were not *"knowingly concerned"* because they were not aware that what Avacade and AA were doing was wrong. There were numerous authorised third-parties involved, upon whom they relied, and the FSA/FCA had not taken any steps to prevent those third parties from so acting.

Perhaps unsurprisingly, the Deputy Judge had *"no real hesitation"* in rejecting that argument (at [462]). In short, all of the individual defendants were directors or senior managers of the Avacade/AA who had, over time, helped to develop and taken equal responsibility for the business models operated. Further, it was apparent that they had each substantially profited from those business models.

VIII. Conclusion

Were there to have been any previously, this judgment leaves very little room for doubt as to the FCA's intentions with regard to unregulated introducers who operated in relation to pension transfers to SIPPs. Its effect is to clarify and confirm a number of key points of guidance and interpretation, almost exclusively in favour of the regulator.

Although the final orders have yet to be decided the FCA has indicated through a press release on its website[3] that, although Avacade went into liquidation in 2015, it intends to seek orders banning AA and the directors of both companies from engaging in further unauthorised activities. Further, to ask the court to determine sums payable by those defendants by way of restitution.

More widely, however, it also provides useful new guidance on the meaning of article 25, as well as reiterating the correct approach to various other provisions in the RAO and FSMA.

Those in the SIPP industry and beyond would be well-advised to sit up and take note…

[3] https://www.fca.org.uk/news/press-releases/high-court-finds-against-illegal-pension-introducers-avacade-and-others.