Neutral Citation Number: [2021] EWHC 2523 (Admin)

Case No: CO/3632/2020

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
ADMINISTRATIVE COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 20/09/2021

Before :

The Honourable Mrs Justice Collins Rice

- -

Between :

THE QUEEN on the application of:
(1) NICHOLAS CHADWIN
(2) SUSAN AYALON
(3) GWYN JONES
(4) NIGEL GILLEY

Claimants

- and -

FINANCIAL SERVICES COMPENSATION SCHEME LIMITED

Defendant

- -
- -

Mr Michael Furness QC (instructed by APJ Solicitors) for the Claimants
Mr Thomas Samuels (instructed by Bevan Brittan LLP) for the Defendant

Hearing date: **27th July 2021**

- -

Approved Judgment

Covid-19 Protocol: This judgment was handed down remotely by circulation to the parties' representatives by email, release to BAILII and publication on the Courts and Tribunals

Judiciary website. The date and time for hand-down is deemed to be 9am Monday 20th September 2021.

The Honourable Mrs Justice Collins Rice:

Introduction

1. The Claimants in this case are individuals who entered into bond investments with the involvement of a stockbroking firm called Beaufort Securities Ltd. The bonds failed and the Claimants sustained significant losses. Then Beaufort went into administration.

2. The Defendant, 'the FSCS', administers a statutory scheme, set up under the Financial Services and Markets Act 2000, of 'last resort' compensation, subject to criteria, for people with claims against providers of financial services who are 'unable, or likely to be unable, to satisfy claims against them'.

3. The Claimants bring these Judicial Review proceedings to challenge the lawfulness of the FSCS's refusal to award them compensation in respect of their losses.

Background

4. The Claimants had each originally invested, with the assistance of a different financial services provider, in an unregulated bond promoted by a firm called Aegis Power Plc – the Aegis 'wind bond'. This had a maturity date in 2024.

5. In January 2015, Aegis created a new bond – a regulated debenture: the Aegis 'power bond' – an investment in UK wind turbine power. The Claimants were sent a marketing document about the power bond and invited, in effect, to convert their wind bond investments into power bond investments on a like for like basis. The conversion was to be effected by the Claimants authorising and instructing Beaufort to do so. They all applied for the conversion, signing forms to the latter effect. The conversions were duly executed by Beaufort over the second half of 2015 and early 2016.

6. The marketing document which the Claimants had received was issued by Beaufort, as the corporate broker for Aegis. It included the following:

> RELIANCE ON THIS NOTE FOR THE PURPOSE OF ENGAGING IN ANY INVESTMENT ACTIVITY MAY EXPOSE AN INDIVIDUAL TO A SIGNIFICANT RISK OF LOSING ALL OF THE FUNDS, PROPERTY OR OTHER ASSETS INVESTED OR OF INCURRING ADDITIONAL LIABILITY.
>
> By receiving this document, you will not be deemed a client or provided with the protections afforded to clients of Beaufort Securities. When distributing this document, Beaufort Securities is not acting for any recipient of this document and will not be responsible for providing advice to any recipient in relation to

> this document. Accordingly, Beaufort Securities will not be responsible for providing the protections afforded to its clients.
>
> …
>
> This document does not provide individually tailored investment advice. It has been prepared without regard to the individual financial circumstances and objectives of persons who receive it. The appropriateness of a particular investment or currency will depend on an investor's individual circumstances and objectives. The investments and shares referred to in this document may not be suitable for all investors.
>
> …
>
> Neither Beaufort securities nor its advisers, directors or employees accepts any liability whatsoever (in negligence or otherwise) for any loss howsoever arising from any use of this document or its contents or otherwise arising in connection with this document (except in respect of wilful default and to the extent that any such liability cannot be excluded by the applicable law). This document is not to be relied upon and should not be used in substitution for the exercise of independent judgment.

7. There is no evidence that any other terms and conditions were communicated to the Claimants. They did not take any independent professional financial advice.

8. Both the wind and the power bonds were placed into administration in August 2016. The Claimants lost the entire value of their investments. In March 2018, Beaufort was placed into special administration by the High Court, in connection with allegations of fraud and money laundering.

The Claimants' potential claim against Beaufort

9. The Claimants say that they would have had a cause of legal action against Beaufort and that they were, in effect, mis-sold the power bonds. It is fair to say that the precise nature of their complaint has evolved over the period since the initial shock of the failure of the bonds. It is also fair to say that it has continued to evolve over the course of these proceedings. I set out below my understanding of the Claimants' matured and considered position, in the context of the relevant legal and regulatory framework.

10. The Financial Conduct Authority (FCA), the conduct regulator for financial services firms, issues a 'Conduct of Business Sourcebook' (COBS) which sets out rules and guidance to be observed by the financial services sector. Chapter 10 of COBS sets out rules requiring firms providing financial services to 'assess the appropriateness', in the circumstances of individual investors, of certain investments. If a firm assesses an investment not to be appropriate for a client, it must warn the client. If the client asks the firm to go ahead despite the warning, the firm must consider whether or not, in all the circumstances, to do so. The rules on assessing appropriateness provide important protections for investors.

11. There are exceptions to the requirement to assess appropriateness. By COBS rule 10.4.1R(1):

> A firm is not required to ask its client to provide information or assess appropriateness if:
>
> (a) the service only consists of execution and/or the reception and transmission of client orders, with or without ancillary services, it relates to particular financial instruments and is provided at the initiative of the client;
>
> (b) the client has been clearly informed (whether the warning is given in a standardised format or not) that in the provision of this service the firm is not required to assess the suitability of the instrument or service provided or offered and that therefore he does not benefit from the protection of the rules on assessing suitability; and
>
> (c) the firm complies with its obligations in relation to conflicts of interest.

12. The Claimants say that Beaufort failed to comply with its regulatory duty under COBS Chapter 10 to assess the appropriateness of the power bonds for them. It is not in dispute that Beaufort did not in fact make any such assessment, nor that, apart from the provisions of COBS 10 themselves, it is a non-excludable duty. What the Claimants say is that, while the exemption from the duty in COBS 10.4.1R(1) was potentially engaged, it could not be relied on because limb (b) was not satisfied. The only 'information' they received was that contained in Beaufort's marketing document. And, they say, that does not comply with the requirements in limb (b). So there was an actionable breach of the duty to assess appropriateness.

The Claimants' application to the FSCS for compensation

13. The statutory scheme administered by the FSCS is governed by the compensation module of the FCA Handbook ('COMP'). It is a discretionary scheme, and the FSCS has power to award compensation subject to eligibility criteria (set out in Chapter 3 of COMP). It is not controversial that what might be termed the gateway eligibility criteria were satisfied in this case: Beaufort was 'a relevant person … in default' and the Claimants were 'eligible complainants'. The sole issue was whether they had a 'protected claim' – namely a 'valid claim' against Beaufort 'in respect of civil liability'. The burden is on applicants to the scheme to satisfy the FSCS that they do.

14. The FSCS emphasises that, while identifying and evaluating a 'valid claim' is part of its function in applying the eligibility criteria, and is approached on the basis of considering 'whether a court would decide in applicants' favour and award them damages', this is an essentially administrative rather than quasi-judicial function; it cannot and does not formally adjudicate on matters of disputed legal entitlement. It also emphasises that, while the 'valid claim' criterion is relatively straightforward to administer in relation to claims in debt, it is less straightforward to administer in relation to claims in negligence or breach of statutory duty. In circumstances of complex insolvency, where information may be incomplete and accounts at variance, it has a

certain inevitable breadth of discretion in seeking to make a fair assessment of the existence or otherwise of a 'valid claim'. It is effectively considering whether applicants have discharged their burden in the matter and will not be 'satisfied' unless they have.

15. More generally, the FSCS scheme is set up to be free at the point of service and run on a non-legalistic basis accessible to ordinary complainants. It is funded by a levy on the industry, and as such is subject both to financial capping of the amount of 'fair compensation' which may be awarded, and to obligations as to efficiency. This, the FSCS says, underlines the essentially administrative nature of the function.

16. The Claimants applied to the FSCS for compensation between June and August 2018, on a variety of grounds. The FSCS rejected their applications between August and September 2019 on the basis, among other things, that there was 'no evidence' that Beaufort had been required to assess the suitability of the investments for the Claimants; there was insufficient indication that Beaufort had been at fault, so the Claimants did not have a 'valid claim' against it.

17. The Claimants endeavoured to get the FSCS to look again at their case. The FSCS did undertake a review of their claims, but confirmed its conclusions as unchanged by a final decision letter of 9th July 2020. The decision letter explained its approach to the Claimants' solicitors as follows:

> Each client will only have a valid legal claim if a firm breaches one of the FCA's rules which firms must follow; or is in breach of any contractual or common law duties to your clients. In addition your clients must also show that they have directly suffered a loss because of that breach, and not as a result of something else.

18. The decision letter set out each of its conclusions, together with reasons addressing the Claimants' variety of complaints. On the point about whether Beaufort should have undertaken an assessment of appropriateness, the letter said it found no evidence that the firm was required to do so. The letter set out the terms of COBS 10.4.1R(1) and stated that it found all three limbs satisfied. As to limb (b) it said this:

> On the evidence we have seen … any personal communications that the Firm made to your clients were initiated by your clients first reading a personalised advertisement that was prepared by Aegis. The correspondence from Aegis … explained how investments in the Bond could be made through a stockbroking account with the Firm. Furthermore … your clients were informed [by the marketing document] that the investment may not be suitable for all investors, and that the document did not provide individually tailored investment advice.
>
> It is clear from this that the Firm was acting as a corporate broker on the instructions of your clients to execute a transaction on an execution-only basis. A corporate broker acting in this way would not normally engage the 'appropriateness' rules under COBS 10. As regards the Claims, the Firm did not assess the

> appropriateness of the Bond and did not give advice in respect of it. The Firm's involvement related solely to reception and transmission of client orders, and we have seen no evidence that the Firm either requested information from clients regarding their risk appetite or assessed the appropriateness of the investment for individual clients. Furthermore, we note that the Bond Marketing Document itself which was prepared by the Firm stated at page 4 that "… *This document does not provide individually tailored investment advice. It has been prepared without regard to the individual financial circumstances and objectives of persons who receive it. The appropriateness of a particular investment or currency will depend on an investor's individual circumstances and objectives. The investments and shares referred to in this document may not be suitable for all investors*". … This should, therefore, have made it quite clear to your clients that they did not benefit from the protection of the rules on assessing suitability.
>
> …
>
> Based on the above, we have concluded that the Firm was not required to assess the appropriateness of the Bond and nor did it. All of the evidence we have seen supports the position as set out in the decision letters that your clients purchased on an execution-only basis; were aware from the Bond Marketing Document that the firm was not advising on appropriateness and that no conflict of interest existed between the Firm and your clients.

The Claimants' application for Judicial Review

19. The Claimants bring these Judicial Review proceedings to test whether the FSCS was lawfully entitled to reach that conclusion. They put their challenge in a number of ways. They say the FSCS misconstrued or misdirected itself to the correct meaning of COBS 10.4.1R(1), and misapplied it to the facts of the case. They say it was not properly open to the FSCS to find on the facts that limb (b) was satisfied by the Beaufort marketing document so that the duty to assess appropriateness was properly excluded.

20. Although at some points described by the Claimants as a question of mistake of law, the FSCS say it is more accurately described as a rationality challenge, and that the question raised on this Judicial Review is not so much the correct meaning of COBS 10.4.1R(1)(b) but whether the decision that the marketing document matched its description was unsustainably irrational.

21. I agree that that is the better view of the question. The *meaning* of COBS 10.4.1R(1)(b) – as to which, it appears, there is neither guidance nor decided authority to refer to – is not particularly obscure or controversial, and was not the focus of these judicial review proceedings. The question the Claimants bring before the Administrative Court is not what the rule means, but whether or not they were '*clearly informed*' in the marketing

document that Beaufort '*was not required to assess the suitability*' of the power bond investments and that '*therefore they did not benefit from the protection of the rules on assessing suitability*'. These are questions not about the meaning of the rule but about the construction of the marketing document and its application to the facts, and the FSCS's approach to that.

22. The Claimants say that the FSCS could not reasonably have found the marketing document to have 'clearly' given them this information. I was shown what might be described as a standard COBS 10.4.1R(1)(b) warning to see what 'clearly' looks like. The Claimants say that the drafting of the marketing document came nowhere near. The document explained that it did not in itself create a client relationship. It gave generalised explanations about appropriateness depending on individual circumstances. It gave generalised warnings not to rely on it. But what it did not do – 'clearly', or at all – was to set out (a) not just that Beaufort had not in fact assessed client suitability but that *it was not required* to assess suitability and (b) that there were rules on assessing suitability, which were for the protection of investors, but from which they *therefore did not benefit*. That, say the Claimants, is not altogether surprising since this was after all simply a marketing document. But the COBS 10.4.1R(1)(b) information was not provided anywhere else or at any other point to the Claimants either.

Consideration

(i) Rationality

23. The essence of the Claimants' argument is that COBS 10.4.1R(1)(b) is there for a purpose which goes beyond generalised warnings to potential investors that they are not being advised and are proceeding at risk. It is a condition which must be fulfilled before a provider of execution-only services is entitled to rely on the exclusion of the duty to assess appropriateness. It requires explicit information about the regulatory position in relation to the provision of a particular '*service*' by a particular firm to a particular *client*.

24. Here, the relevant service is not the provision of information to prospective customers in a bond marketing communication (or 'research brochure'), about which the usual heavy caveats as to the limits of reliability and reliance may well be expected. The relevant service is the execution of the bond transfer transaction. COBS 10.4.1R(1)(b) requires that *clients* be put on clear notice that *that* service is one where the provider is formally exempt from the legal duty to assess appropriateness *and* that the normal appropriateness rules for the protection of investors have been disapplied. That goes beyond a wise caution to get independent advice about a potential investment. It is important information for clients of execution-only services about their legal position.

25. The FSCS makes a number of points about the correct approach to this issue. First, it says, entirely correctly, that the question is not whether the reviewing court considers that the marketing document 'clearly' imparts the necessary COBS 10.4.1R(1)(b) information; it is whether the FSCS could rationally have thought that it did.

26. Second, that in turn has to be reviewed against the background of the FSCS's proper statutory functions, as summarised above. Third, the reviewing court must show due deference to the expertise and experience of the expert body designated by Parliament for the purpose of making precisely these sorts of decisions (see paragraphs 61 and 62

of *ABS Financial Planning v FSCS & FSA* [2011] EWHC 18 (Admin)). I agree with both of these points also, although the construction of the marketing document is perhaps not an especially technical exercise.

27. Fourth, the FSCS says that the exercise needs to be approached from an essentially purposive perspective, not by lawyerly parsing of text but by considering what understanding would have been clearly conveyed to the intended readership. It points out that COBS 10.4.1R(1)(b) is non-prescriptive as to format or method; the rule is concerned with the practicalities of getting the message across sufficiently effectively and that can (and should) be done in simple terms accessible to a lay reader and not by reference to regulatory formulae. And fifthly, the FSCS says that whether a client has been 'clearly' informed of something is obviously a value judgment with a built-in measure of latitude in any event.

28. These are all well-made points, with which I agree, and I approach the Claimants' challenge on this ground with suitable circumspection. To the FSCS's points I might add, of course, that the decided authorities give unmistakeable warnings about how high a bar irrationality should properly be considered by a reviewing court. The court should think of interfering only if it is satisfied that no reasonable decision-maker acting on behalf of the FSCS, and properly directing themselves, could have rejected the Claimant's claim on this ground.

29. Adopting this approach, and in particular setting aside the issue of degrees of 'clarity', it seems to me that the Claimants' case ultimately turns on two issues.

30. The first is whether the marketing document discloses *any* basis for concluding that the Claimants were informed that by engaging the services of Beaufort on an execution-only basis to effect the bond transfer, that service was *not only* non-advisory *but also* exempt from the duty to assess appropriateness *and further* that, as a result of that exemption, they did not *benefit from the rules* on assessing suitability.

31. Reading the marketing document fairly, as a whole, and with all the proper circumspection of a reviewing court, I cannot see that it does. It is a marketing communication. It describes an investment opportunity, the power bonds, offered by Aegis, in suitably caveated fashion as regards the information in the document itself. The Claimants were existing Aegis bond-holders with holdings that were otherwise irredeemable at this point, and if they wanted to take advantage of the special new opportunity then the procedure for doing so was to be to instruct Beaufort to execute their wishes. But so far as I can see the marketing document says nothing at all about that procedure (or 'service').

32. That is not surprising: the engagement of Beaufort on a transactional basis was the *next* stage, if a potential investor wanted to go ahead. The document does not, and says in terms that it does not, create a client relationship by itself. For the purposes of issuing the marketing document, Beaufort is described in it simply as acting 'as corporate broker to the relevant issuer'. Indeed, the indication in the marketing document that '*Beaufort Securities will not be responsible for providing the protections afforded to its clients*' might reasonably be thought to indicate that, in the conduct of any future client relationship, protections *would* be afforded.

33. The FSCS decision letter relies on the marketing document's self-description as not itself providing individually tailored investment advice, and as warning that appropriateness will depend on each individual's circumstances and that the power bonds may not be suitable for all investors. But that is simply not the same thing as telling the reader that any future transaction involving the trading-in of their existing bonds in return for power bonds will be undertaken by a stockbroker (even, as it happens, the same firm) on the basis that it is not *required as such* (that is, '*in the provision of this service*') to assess the appropriateness of that transaction – at any point or in any form – and that the investor will therefore not benefit in any way from the protection of the rules on assessing suitability. The former is a description of the (non-)effect of a marketing communication on its readership at large; the latter is a statement of the (non-)applicability of specific legal entitlements in a client/provider relationship. Deducing the latter from the former is a non-sequitur; regarding them as the same thing is an error of analysis and a failure to have regard to the purpose and effect of COBS 10.4.1R(1)(b) (non-compliance with which re-imports the duty to assess appropriateness even when providing an execution-only service); any of these discloses a defect of rationality.

(ii) Causation

34. That takes the present application to the second of the two issues on which the Claimants' case turns. That is the issue of causation. Causation arises as an issue in two stages in this case. First, the Claimants had to satisfy the FSCS that any failure by Beaufort to comply with COBS 10.4.1R(1)(b) caused them financial loss – otherwise they could not have satisfied the FSCS that they had a 'valid claim' against the firm. And second, at the Judicial Review stage, I have to be satisfied that, had the FSCS's decision not disclosed any defect of rationality, it would not have gone on to reject the Claimants' application for compensation in any event on proper grounds. The latter is a particularly weighty matter. By section 31(2A) of the Senior Courts Act 1981, a reviewing court is prohibited from granting relief '*if it appears to the court to be highly likely that the outcome for the applicant would not have been substantially different if the conduct complained of had not occurred*'.

35. As to the burden on the Claimants to satisfy the FSCS of the causal component of their claim against Beaufort, the FSCS decision letter does draw attention to this requirement: '*In addition your clients must also show that they have directly suffered a lost because of that breach, and not as a result of something else*'. What the Claimants had said about this at the time was that (a) Beaufort was on a proper analysis under a duty to assess the appropriateness of the transfer from wind bonds to power bonds; (b) if it had done so, it would have found this not to be suitable for the Claimants and issued them with a warning; (c) on the balance of probability a reasonable person in the Claimants' shoes would not then have made the switch.

36. The FSCS letter did not address the issue of causation substantively; it did not have to because it had found no actionable fault by Beaufort in the first place. But the FSCS says nevertheless that it did consider the issue of causation; and that it is 'inevitable' they would have rejected the Claimants' applications anyway because they would have suffered the losses they did in any event. Its reasoning goes as follows.

37. The Claimants had all invested in the original wind bonds. Beaufort had nothing to do with that. Beaufort entered the picture only in February 2015 when Aegis appointed it

as its corporate broker in relation to the power bonds issue. The earliest point at which any of the Claimants could have redeemed their wind bond investments was five years after they had been issued, that is, in June 2019. Up until that date they were effectively contractually locked in to the wind bonds. The switch to the power bonds came along in the meantime as a unique alternative prospect. Both the wind bonds and the power bonds were placed into administration (and lost all their value) in August 2016. So even if every step of the Claimants' counterfactual is followed through – Beaufort had assessed the power bonds as inappropriate, Beaufort had warned the Claimants, and the Claimants had kept the wind bonds and not made the switch – they would have lost all their investment anyway. The investment they had made in each bond was on an exact like for like basis. No possible default by Beaufort caused the collapse of the original wind bonds or the Claimants' losses – it had nothing to do with them.

38. Although this is not set out in their decision letter, the FSCS creates a set of Standard Operating Procedures (SOPs) in circumstances where it foresees that a certain state of affairs is likely to generate multiple applications for compensation. These set out a general analysis of the situation to guide its claims-handlers in applying the eligibility criteria and making decisions in individual cases. It had created a SOP in relation to power bond claims against Beaufort. The SOP included this:

> FSCS believe that where a customer had taken out an unregulated and unlisted bond prior to 13th February 2015 and prior to Beaufort's involvement, they are not entitled to any compensation against [Beaufort].
>
> As the customer had already invested in the bond, Beaufort's involvement has not caused them any further losses. This is because the original bond would have returned no monies to the customer prior to the firm going into administration on 2nd August 2016.

39. The FSCS says that this would have been a complete answer even if the Claimants could have satisfied it that Beaufort had been in breach of its statutory duty. They still would have no 'valid claim' sounding in damages against the firm. So they were not eligible for compensation.

40. The Claimants come at this difficulty from various angles. They say the FSCS simply did not grapple with any of this in its decision letter, because the decision proceeded on an erroneous footing that there was no breach; it therefore made no investigation into or findings about Claimants' losses; and they *have* suffered a loss because of Beaufort: they have lost the opportunity to proceed against the firm involved in selling them the original wind bonds.

41. The difficulty for the Claimants, however, remains. So far as I can see, the proposition that they lost a potential claim against the original firm was not put to the FSCS in any detailed and evidenced way so as to advance it beyond a mere theory (or at all). The burden was on them to persuade the FSCS of the existence and recoverability of any such claim in the first place, and of their loss as a result of the conversion of the bonds (such that damages would have been recoverable from Beaufort). On the materials before them the FSCS was entitled not to have been satisfied on this point. Apart from that point, the logic of the FSCS's position seems to me to be compelling, and no

obvious answer to it appears. Even on all the counterfactual assumptions most favourable to the Claimants, they would highly likely have found themselves still locked into the original wind bonds and in no better, or worse, position with regard to their losses.

42. It appears to me in all these circumstances to be highly likely that the outcome for the Claimants would not have been substantially different if the 'conduct complained of had not occurred'. Even if the FSCS had been satisfied that Beaufort was in breach of its statutory duty to make an assessment of appropriateness in effecting the replacement of the wind bonds with the power bonds, it would still have been entitled to hold the Claimants ineligible for compensation on the grounds that they had not satisfactorily established that they had a 'valid claim' against Beaufort – and, particularly given the SOP, highly likely that it would have done so. It was not satisfied, and was entitled not to be satisfied, that the Claimants had made a sufficient causal link between the breach and any recoverable losses. It was, in all the circumstances, entitled to conclude that the Claimants had not discharged their burden, and I am satisfied in those circumstances that it is highly likely that that is the decision it would have made.

43. Most unfortunately for the Claimants, however much they may regret the involvement of Beaufort in their financial affairs, the alternatives do not appear to have offered a better prospect for them. Even if Beaufort was at fault, it was not Beaufort's fault that both the wind bond and the power bond failed, and that made the Claimants' losses inevitable. The FSCS's remit begins and ends with the consequences of Beaufort's actions. But the Claimants' financial predicament is not demonstrably worse because of Beaufort than it would have been anyway. Not all investment losses are eligible for compensation. The FSCS was entitled in all the circumstances to find that the Claimants' situation was not covered by the statutory scheme.

Decision

44. For this reason, having reviewed the exercise of its functions by the FSCS in their cases, I refuse the Claimants the remedy they seek.