THE HIGH COURT

[Record No: 2011/219 MCA]

In the Matter of Custom House Capital Limited (in liquidation) and

In the Matter of the Companies Acts, 1963 – 2012

BETWEEN/

THE INVESTOR COMPENSATION COMPANY DAC

APPLICANT

AND

KIERAN WALLACE, OFFICIAL LIQUIDATOR

RESPONDENT

Judgment of Ms. Justice Finlay Geoghegan delivered on the 31st day of January, 2019.

Application

1. The Investor Compensation Company DAC ("ICCL") has applied to the Court to direct the official liquidator to bring an application for directions pursuant to s. 231 of the Companies Act 1963 or alternatively, to permit it to bring an application for directions in relation to a dispute concerning its claim to be entitled to be subrogated to the right (or certain of the rights) of clients of Custom House Capital (in liquidation) ("CHC") to whom it has paid compensation ("a compensated client") in relation to client assets still under the control of CHC or the liquidator.

2. This application was heard following initial directions when the matter was mentioned by ICCL before the Court. There is no formal notice of motion as yet. The Court has had the benefit of written submissions on behalf of ICCL and the official liquidator and oral submissions from Counsel on their behalf. It also briefly heard from Counsel for Mr. Nugent, who was a client of CHC who has participated in many applications to date and who was notified by the liquidator that he is a client who would be potentially affected by the application sought to be made.

3. By agreement, ICCL handed into court at the hearing a booklet which included the correspondence which has passed between the solicitors for the liquidator and ICCL in relation to the subject matter of this application since February 2018.

Statutory Framework

4. The Investor Compensation Act 1998 (as amended) ("the 1998 Act") gives effect to Directive No. 97/9/EC of the European Parliament and of the Council of 3 March 1997 on investor compensation schemes ("the Directive"). The Directive obliges Member States to have an investor compensation scheme which, in accordance with Art. 2 thereof, requires cover to be provided for claims arising out of an investment firm's inability to repay money owed to or belonging to investors or to return to investors instruments belonging to them, each in connection with an investment business. It is primarily aimed at small investors and requires a minimum cover of not less than €20,000 for each investor in respect of claims covered and permits, subject to this minimum, Member States to impose a limit on compensation.

5. Article 12 of the Directive provides:

> "Without prejudice to any other rights which they may have under national law, schemes which make payments in order to compensate investors shall have the right of subrogation to the rights of those investors in liquidation proceedings for amounts equal to their payments."

6. The 1998 Act established ICCL. Part III provides for the payment of compensation to investors in the amount of what is termed "compensatable loss". This is defined in s. 30(1) as 90% of an eligible investor's net loss or €20,000, whichever is the lesser. A "net loss" is defined in s. 30(1) as:-

> "'net loss', in relation to every client of an investment firm, means the amount of the liability of the investment firm in respect of—
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> (a) money owed to or belonging to the client and held on behalf of the client by the investment firm in connection with the provision of investment business services by the investment firm, and
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> (b) investment instruments belonging to a client of the investment firm, and held, administered or managed by that firm for the client, in connection with the provision of investment business services by that firm to the client, the value of those instruments being determined, so far as possible, by reference to their market value
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> on the day of a determination made under section 31(3) or a ruling, as appropriate, which the investment firm is unable to discharge in accordance with the legal and contractual conditions applicable but shall not include—..."
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> [The exclusions are not relevant to this application]

7. Section 33A provides for the Court to appoint the person appointed as liquidator of an investment firm also as administrator for the purposes of the 1998 Act. Hence Mr Wallace, the official liquidator of CHC, is also the administrator for the purposes of the compensation scheme under the 1998 Act. As administrator, he is obliged pursuant to subss. 33(3) and (3A) to provide to ICCL a statement or interim statement specifying the names of eligible investors and either the net loss (if any) and the compensatable loss (if any) or, in the case of an interim statement, the estimated net losses (if any) and the estimated compensatable loss (if any) of the eligible investors. Section 35 provides for the payment of compensatable losses as informed by the administrator (subject to provision for resolution of disputes or appeals) in relation to the amount of compensatable loss.

8. Subsections 35(5) and (5A) are central to the application sought to be made by ICCL. These provide:-

> "(5) Where the Company or the operator of an investor compensation scheme approved under section 25 has made a payment under section 34 to an eligible investor, the Company or operator shall be subrogated to the rights of that eligible investor in liquidation proceedings against the investment firm for an amount equal to the amount paid by the Company or the compensation scheme under section 34 to that eligible investor.
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> (5A) If—
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> (a) an eligible investor proves a claim in the liquidation proceedings referred to in subsection (5), and
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> (b) the amount proved exceeds the amount of compensation paid by the Company, or by the operator of a compensation scheme approved under section 25,
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> the claim of the eligible investor and the subrogated claim of the Company, or operator of the compensation scheme, for the amount of the excess rank equally in those proceedings and are to be paid proportionately. If the assets are insufficient to meet those claims, they are to abate in equal proportions."

Liquidation of CHC

9. The order for the winding up of CHC was made on 21 October 2011. On the same day, Mr. Wallace was appointed as administrator of CHC for the purposes of the 1998 Act. In March 2011, CHC had client assets in excess of €1.1bn under management and €24m in cash in designated client accounts. The number of clients at that point in time was put at in excess of 1,500. Prior to commencement of the winding up, the inspectors appointed by the Court had estimated misappropriation of client funds in very significant amounts. It was clear from the outset that there would be applications for payment of compensation under the 1998 Act. Provision was made in the winding up order that ICCL be on notice of all applications in the liquidation as it has been. Client funds comprised many types of investments broadly divisible into equities, property investments and cash funds. These included many pension products to which clients had no immediate right of access such that "distribution or return to a client" required them to be transferred to an approved person or body. The nature of the control or connection of CHC with client funds also greatly varied. From early in the liquidation, the liquidator distinguished between client assets he considered to be segregated and pooled.

10. CHC's own assets are, in relative terms, minimal. Any entitlement of ICCL to be subrogated to any claim of a client against CHC to be satisfied out of company assets is purely theoretical and is not sought to be made the subject of the proposed application. Paucity of company assets has also given rise to many issues and several applications in relation to the potential payment of the liquidator's fees and expenses. Complex issues have also arisen in relation to return of client assets by reason *inter alia* of misappropriations and the nature of the assets. ICCL has been on notice of all the applications and participated in some. The applications and the judgments given on them may be relevant to the resolution of the difficult issues raised by this application. They have also given the Court extensive knowledge of the details of client assets and the issues in the liquidation.

The Dispute and Application

11. ICCL identifies at para. 16 of its written submissions that it is necessary for the Court to "determine whether the statutory subrogation right under section 35(5) of the 1998 Act extends to client assets and, if so, to which client assets". It helpfully identifies (subject to further refinement) the questions which it submits the Court would be asked to decide in any such application to be:

> "(a) Whether the ICCL's right of subrogation under section 35(5) of the 1998 Act, or otherwise, is restricted to the assets of CHC or whether it extends also to client assets held by CHC;
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> (b) If the ICCL's right of subrogation extends to client assets, the basis for determining what client assets the right of subrogation is exercisable against;
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> (c) Whether ICCL's right of subrogation, if it extends to client assets, applies only to client assets in respect of which compensation has actually been paid (or whether it applies to all client assets, or only client assets which made up the calculation of "net loss";
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> (d) Whether ICCL's right of subrogation, if it extends to client assets, but is confined to those client assets in respect of which compensation has actually been paid, is allocated between different forms of said assets by reference to the compensation payment attributable to each from, or on any other basis;
>
> (e) Whether ICCL's right of subrogation, if it extends to client assets, but is confined to those client assets which form part of the calculation of "net loss", is allocated on any particular basis between the said assets".

12. For the reasons already set out, the right of subrogation which ICCL may have by reason of payment of compensation pursuant to s. 35(5) is only of practical benefit if the right extends to client assets. There will be no dividend paid by CHC to any creditor. The liquidator in the correspondence from February 2018 disputes that any right of subrogation ICCL may have extends to client assets. Whilst that is potentially a headline dispute, it is immediately obvious from a reading of subss. 35(5) and (5A) and the knowledge the Court has of this liquidation and in particular the many types of client assets, that there are a considerable number of other questions which would fall to be determined before it could be decided that ICCL is now entitled to be subrogated to an identified right or claim of any compensated client in relation to a specified client asset. The questions identified by ICCL are the minimum which would probably have to be determined and it appears to me from an initial consideration of subss. 35(5) &(5A) and some general principles in relation to subrogation that, in the context of this liquidation and the stage it has reached, there are probably a number of other questions which would fall for determination if ICCL now claims a right to be subrogated to the rights of compensated clients to their client assets.

13. Hence, the ICCL appears correct in its contention that the resolution of any disputed claim to be entitled to be subrogated to some or all of the rights of a compensated client of CHC to the return of his own assets, whether by payment, transfer of assets at the client's direction, or otherwise, will as a matter of probability require the determination by the Court of a number of issues including but not limited to those identified at para. 16 of ICCL's submissions. Neither the Directive nor the 1998 Act defines what is meant by subrogation in s. 35(5) of the 1998 Act. Further, at present it is not clear to which rights of a compensated client ICCL is claiming an entitlement to be subrogated. I have considered carefully the correspondence between William Fry and McCann Fitzgerald

and it appears to me that there may be some difference in the approach suggested in the letter of 23 October 2018 from William Fry on behalf of ICCL at p. 2, and the nature of the right as explained in paras. 6 and 7 of ICCL's written submissions.

14. It is not my intention to express any view in this judgment on the substance of ICCL's claim to be entitled to be subrogated to certain rights of compensated clients. I only wish to draw attention to the potential complexity of issues which will be raised by any claim which ICCL may now make pursuant to subss. 33(5) and (5A) of the 1998 Act to be entitled to be subrogated to rights of compensated clients to client assets not yet returned to them in this liquidation. I use the term "compensated clients" as it is at least clear that the right of subrogation only arises where ICCL "has made a payment under section 34 to an eligible investor".

Conclusion

15. I have concluded that the Court should only decide any disputes concerning claims by ICCL to be entitled to be subrogated to rights of compensated clients of CHC to their client assets in relation to actual claims made and disputed. In order that a Court could properly consider and decide the probable many issues, it is necessary that it be done in relation to actual facts pertaining to identified clients and their assets not yet returned. Hence, ICCL will have to identify the compensated clients (or at least a representative sample thereof) and the rights of those clients to which it claims to be entitled to be subrogated in relation to client assets not yet returned. I appreciate that this may require ICCL, if it decides to pursue such claims, to obtain in relation to any compensated client in respect of whom it seeks to make such a claim, further information from Mr. Wallace, either as administrator or as official liquidator. I see no reason why this cannot be done. I assume if compensation has been paid, then the net loss or estimated net loss of the client has been determined.

16. A question arose on this application as to whether the proposed application (or by implication any application) for directions in relation to a dispute concerning a claim by ICCL to be entitled to be subrogated to a compensated client's rights in relation to his client assets not yet returned could be brought in the liquidation proceedings. ICCL correctly contends that the Court has already identified that the work being done by Mr. Wallace as official liquidator in relation to client assets, whether it is termed distribution or disengagement of CHC from control of client assets, is work which he is required to do as part of the orderly winding up of CHC (see para. 43 of the judgment delivered on 9 October 2012: *Re Custom House Capital Ltd. (in liquidation)* [2012] IEHC 382, [2012] 3 I.R. 93, and para. 33 of the judgment delivered on 22 December 2014: *Re Custom House Capital Ltd. (in liquidation)* [2014] IEHC 705). If ICCL were to make claims to be subrogated to the rights of identified compensated clients in relation to his assets still remaining under the control of CHC and those claims are (as is probable) disputed, then it may be that such disputes should be determined by an application in the liquidation proceedings. I would add that whilst the subject matter of the potential dispute may relate to the work which the official liquidator is required to do as part of the winding up, it does not necessarily follow that he would be obliged to bring an application for directions under s. 231 where the essential dispute is between ICCL as claimant and clients who opposes the ICCL's right to be subrogated.

17. However, the present directions sought by ICCL do not relate to identified claims. For the reasons already stated, they are not at present in a form which could, in my view, properly enable the Court to determine what may be very difficult and complex issues. Accordingly, I will refuse both the present applications of ICCL. I wish to make clear that I am doing so by reason of the fact that there is not a properly identified factually-based dispute between ICCL and one or more compensated clients in relation to particular claims made by ICCL to be subrogated to specified rights of those clients to the return or transfer of their client assets remaining under the control of CHC, which would enable a court to properly consider and decide the many complex issues which will arise on any such disputed claims. I am not deciding now whether, if such disputes arise following specific claims by ICCL, they should be determined on an application made by ICCL in the liquidation proceedings. That is a decision for a future application.

Additional Observations

18. I wish to add a few observations which are *obiter*. I recognise such observations may be unusual and make them only by reason of the fact that I have been the judge principally dealing with applications in this liquidation since 2011 and will cease shortly to hear any further applications and will certainly not hear any application relating to any claims which ICCL may in the future bring, if it decides to make claims to be subrogated to certain rights of compensated clients in this liquidation.

19. Counsel for ICCL emphasised in the course of this application the importance to ICCL of obtaining clarification in relation to its rights of subrogation under the 1998 Act, not only for the purposes of potential claims in this liquidation, but also in relation to future insolvencies of other investment firms. I fully understand that desire. However, whether such clarification may be achievable by making claims to be entitled to be subrogated to certain rights of compensated clients in this liquidation and pursuing applications in relation to inevitable disputes should, I suggest, receive careful consideration by ICCL prior to being made.

20. Subrogation is not defined in either the Directive or the 1998 Act. Whilst a well-established principle or doctrine in law and equity, it does not have a single meaning and how it operates depends on the particular facts and circumstances. It is not easy to envisage that a court in this jurisdiction, or the Court of Justice of the European Union on a reference under Art. 267, will be able to give the type of clarification desired by ICCL even in relation to the questions identified in this application, having regard to the broad terms of ss. 35(5) and (5A) of the 1998 Act and Article 12 of the Directive. It may be inevitable that the type of clarification desired quite reasonably by ICCL necessitates further legislation and possibly the making of detailed regulations. I have noted in the course of considering this application, the different approach taken in the UK for the purpose of implementing its obligations under the Directive. This is done by way of establishment of the Financial Services Compensation Scheme Limited under the Financial Services and Markets Act 2000.

21. The second reason for which I make these observations is the timing of this application and of any future claims by ICCL to be subrogated to rights of compensated clients and the very difficult question of the potential prejudice to clients who receive compensation from ICCL in advance of the return of their client assets, as compared with those clients who may await the payment of compensation until after the return of their client assets. One issue that does not appear to be in dispute is that any subrogation right of ICCL only arises when compensation is paid. This potential prejudice and how it might be approached is well treated in Chapter 7 of in the UK Financial Conduct Authority's Handbook on Compensation under the UK scheme, which sets out the approach to the questions of subrogation under that scheme.

22. This application is made approximately 7 years after the commencement of the liquidation, at a time when the liquidator is (hopefully) nearing completion of distribution of client assets, in accordance with directions given by the Court in 2017, see: *Re Custom House Capital Limited (In Liquidation)* [2017] IEHC 484. ICCL was on notice of that application but did not assert subrogation rights to client assets. The Court was informed on this application that 574 out of approximately 1,900 applicants have been paid compensation by ICCL. In addition to the potential prejudice to those to whom compensation has been paid if ICCL now assert a right to be subrogated to certain of their rights, as compared with those whose claims for compensation are still pending and who may seek (if permitted) to await payment of compensation until after return of client assets, there is the inevitable probability of further significant delay in the completion of this liquidation to the prejudice of many who have already suffered losses if ICCL pursue

subrogation claims.

23. As I stated earlier, these comments are *obiter* and it is a matter for ICCL as to whether they make claims to be subrogated to rights of identified compensated clients. A decision should however be made promptly and notified to the liquidator and clients concerned. It would also appear necessary, if ICCL decides to pursue subrogated claims, that applicants for compensation not yet paid be notified of the potential consequences of payment, in advance of the return of client assets.