# Cases Analysis

**Mark Simpson** and **Julian Hui** of **Baker McKenzie** report on a recent banking law case

## WHETHER A STATUTORY TRUST EXISTS OVER SAFEGUARDED FUNDS HELD UNDER THE ELECTRONIC MONEY REGULATIONS 2011

## *In the matter of ipagoo LLP (in administration)*

[2021] EWHC 2163 (Ch)

The High Court, in its recent judgment *In the matter of ipagoo LLP (in administration)* [2021] EWHC 2163 (Ch) (*Ipagoo*), has determined that no statutory trust exists over safeguarded funds held under the Electronic Money Regulations 2011 (EMRs). This can be contrasted with the decision *In Re Supercapital* [2020] EWHC 1685 (Ch) (*Supercapital*) which found that the Payment Services Regulations 2017 (PSRs) create a statutory trust over safeguarded funds. The *Supercapital* judgment was the focus of our article *Unfinished business? The payment services safeguarding rules after Supercapital* in the December 2020 edition of JIBFL ((2020) 11 JIBFL 734).

The two decisions are difficult to reconcile: where the *Supercapital* decision found that a trust exists, in *Ipagoo* the court came to the opposite conclusion on almost identical legislative provisions. At the same time, where (as discussed in our earlier article) the *Supercapital* decision left a number of unresolved issues, including as to which assets formed part of the "trust" property, the *Ipagoo* decision provides some clear guidance for insolvency officeholders on which funds should be treated as part of the "Asset Pool" of customer funds for distribution.

The *Ipagoo* case involved an application to the court by the Administrators of Ipagoo LLP, an electronic money institution (EMI) in administration, for directions as to the distribution of assets including funds held by the firm in exchange for which e-money had been issued (Relevant Funds). The Administrators sought directions on two questions:

- do the EMRs create a statutory trust of the "asset pool" as defined in reg 24 of the EMR (Asset Pool) for the benefit of electronic money holders (EMHs)? (the First Issue); and
- do Relevant Funds which should have been, but were not, dealt with in accordance with regs 20-22 form part of the Asset Pool (the Second Issue).

The Financial Conduct Authority (FCA) intervened in the proceedings to argue that the EMRs should be viewed as creating a statutory trust. The Administrators were neutral on both arguments but presented arguments against the statutory trust so that the court had the benefit of hearing both sides of the argument.

On the First Issue, the court found that the EMRs *do not* create a statutory trust. The court appears to have been persuaded by factors including:

- the lack of a clear link between an EMH's claim to redemption of e-money and the Relevant Funds (in particular, there being no requirement that an EMH be repaid out of Relevant Funds);
- the entitlement of an EMI to spend any surplus funds remaining after e-money is spent;
- the fact that interest (or dividends, where the firm had invested monies in other permitted Assets) could be expected to accrue on Relevant Funds/Assets, but the EMH was not entitled to that interest/dividends (contrary to the expectation for a beneficiary in a conventional trust); and
- the lack of certainty of subject matter in some circumstances (for example, the fact that where an EMH pays money for two purposes, only one of which is to purchase e-money, the EMI is required to make a reasonable estimate of the Relevant Funds).

The court acknowledged that there are factors pointing to the contrary (the requirement for segregation, and payment to be made to EMHs out of the Asset Pool) but was not persuaded that these were determinative. Additionally, the court was not persuaded that a trust must be present in order to meet the "high level of protection" that the EU-level directives (the EMD and PSD 2) required the UK to afford to EMHs in respect of Relevant Funds.

Despite the lack of a trust, the court found that for the EMRs to be given their full effect, and to ensure the proper implementation of the EMD and PSD 2 in the UK, the distribution rules within the EMRs (requiring that the Asset Pool be paid out to EMHs in priority to all other creditors) override the usual priority rules on distribution in insolvency; in effect, therefore, a similar outcome to the one which would arise on the distribution of trust assets.

On the Second Issue, the court held that Relevant Funds should form part of the Asset Pool available for priority distribution to EMHs, regardless of whether the Relevant Funds had in fact been segregated pursuant to the requirements of the EMRs. Relying on dictum of Lord Dyson in *Lehman Brothers International (Europe) (In Administration)* [2012] 3 All ER 1 (Lehman), the court found that in order to properly implement the EMD and PSD 2 into UK law, the EMRs must be read as requiring a "high level of protection" for *all* Relevant Funds (noting also the prohibition on comingling at any time). This means that Administrators must consider, before distributing assets of an insolvent EMI, whether the EMI received Relevant Funds which should have been (but were not) safeguarded, and if so, a sum equal to those Relevant Funds must be added to the Asset Pool. This would seem to deliver a similar outcome to the position under the statutory trust in *Lehman*, but with that outcome being arrived at through a different statutory (non-trust) route. Objective 1 of the recently introduced Payment and Electronic Money Institution Insolvency Regulations 2021 seeks to ensure this outcome by requiring administrators to identify Relevant Funds held outside of the safeguarding account and transfer them to the safeguarding account as soon as reasonably practicable after appointment/reconciliation.

The *Ipagoo* decision does not overrule *Supercapital*, and is concerned with different legislation – the EMRs, rather than the PSRs – but given the similarities between the safeguarding and distribution provisions for Relevant Funds in the two pieces of legislation, the decision raises questions as to whether these different approaches can be justified. The court in *Ipagoo* acknowledged the contrary decision in *Supercapital* but noted that the court in *Supercapital* had not been presented with arguments to the contrary. Given the inconsistency it would not be surprising for this to come before the courts again.

A practical point for the industry to address is that the FCA's template acknowledgement letter for safeguarding accounts held at banks by EMIs and payment institutions contains an express acknowledgement that Relevant Funds are held on trust. At the very least under the EMRs, that does not now appear to be a correct statement of the legal position and accordingly firms who have been using the FCA's template letters should revisit them. This may also impact on banks holding safeguarding accounts and how they report those accounts under the deposit guarantee scheme. ■

**Louise Lamb** and **Joseph Harrison** of **Hogan Lovells International LLP** report on a recent banking law case

# *Bhattacharya v Oaksix Holdings Limited*

[2021] EWHC 1326 (ch) (26 May 2021)

## LIMITATION OF ACTIONS UNDER FSMA: A DECISION ON THE APPLICABLE LIMITATION PERIODS AND THE ACCRUAL OF CAUSES OF ACTION FOR CLAIMS IN RELATION TO UNREGULATED LENDING

The appellants (the Bhattacharyas) and the respondent (Oaksix Holdings Ltd) had entered into a loan agreement in February 2012, with repayment of the principal due nine months later (the First Loan). The First Loan was subsequently extended such that repayment ultimately fell due in July 2013. At that point, the appellants applied for a new loan intended to refinance the First Loan (the Second Loan). The Second Loan was drawn down on or about 27 August 2013, with the result that the outstanding indebtedness under the First Loan was fully repaid.

On 8 August 2019, the appellants issued proceedings against the respondent, seeking:

- declarations that the First and Second Loans were unenforceable under s 26(1) Financial Services and Markets Act 2000 (FSMA) because they were regulated mortgage contracts and the respondent was not an authorised person under s 19 of FSMA; and
- repayment of the interest and fees paid to the respondent under both the First and Second Loans.

The lion's share of the interest and fees claimed had been paid by the appellants under the First (rather than the Second) Loan.

The respondent served a defence contending among other things that the claims were statute barred. The respondent then applied to strike out the appellants' claim insofar as it related to the recovery of monies paid prior to 9 August 2013 and/or seeking summary judgment in respect of the claim to recover such sums.

By an order dated 15 May 2020, Deputy Master Linwood struck out the claim for repayment of sums paid prior to 9 August 2013 under the First Loan and struck out the claim for a declaration that the First Loan was unenforceable. The Deputy Master also gave summary judgment in respect of these claims.

Permission to appeal was then sought, and granted. The appeal was heard by Elizabeth Jones QC, sitting as a Deputy Judge of the High Court, on 21 April 2021.

## THE ISSUES ON APPEAL

The Deputy Judge identified four key issues to be determined in the appeal. However, her decision ultimately turned on the following two issues:

- whether the Deputy Master had been wrong to find that the claims fell within ss 8(2) and 9 of the Limitation Act 1980 (the Limitation Act) (which meant that a six year period applied) (Issue 1); and
- if ss 8(2) and 9 of the Limitation Act applied, whether the Deputy Master had been wrong to find that time started to run for the purpose of those sections when each of the sums claimed was paid to the respondent (Issue 2).

## ISSUE 1: DID THE CLAIMS FALL WITHIN SS 8(2) AND 9 OF THE LIMITATION ACT?

The Deputy Master had found that the appellants' claim under ss 26(2) and 28(7) of FSMA was subject to a six-year limitation period. This was on the basis that it was a claim for recovery of money which arises only under FSMA, and therefore fell within s 9 of the Limitation Act.