Neutral Citation Number: [2021] EWHC 2163 (Ch)

**Case No: CR-2019-005157**

**IN THE HIGH COURT OF JUSTICE**
**BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES**
**INSOLVENCY AND COMPANIES LIST (ChD)**
**COMPANIES COURT**

Royal Courts of Justice, Rolls Building
Fetter Lane, London, EC4A 1NL

Date: 30/07/2021

**Before** :

**MR DAVID HALPERN QC SITTING AS A DEPUTY HIGH COURT JUDGE**

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**IN THE MATTER OF IPAGOO LLP (IN ADMINISTRATION)**
**AND IN THE MATTER OF THE ELECTRONIC MONEY REGULATIONS 2011**
**AND IN THE MATTER OF THE INSOLVENCY ACT 1986**

**JASON DANIEL BAKER AND GEOFFREY PAUL ROWLEY**
**(As Joint Administrators of ipagoo LLP)**

**Applicants**

**THE FINANCIAL CONDUCT AUTHORITY** **Intervener**

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**Mr Jack Watson** (instructed by **Faegre Drinker Biddle & Reath LLP**) for the **Applicants**
**Dr Riz Mokal** (instructed by the **Financial Conduct Authority**) for the **Financial Conduct Authority as Intervener**

Hearing date: 16 July 2021

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# 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 by the Judge remotely by circulation to the parties' representatives by email and release to BAILII. The date and time for hand-down is deemed to be 30 July 2021 at 10.30am.

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MR DAVID HALPERN QC SITTING AS A DEPUTY HIGH COURT JUDGE

**Mr David Halpern QC :**

1. This is an application by the Administrators of ipagoo LLP ("**ipagoo**") seeking directions as to the distribution of assets. ipagoo is regulated by the Financial Conduct Authority ("**FCA**") as an electronic money institution ("**EMI**"). It is authorised to issue electronic money ("**e-money**") and also to provide multi-country and cross-currency payment account services, designed to enable clients to open and operate non-resident payment accounts in multiple EU countries.

2. EU law draws a distinction between payment institutions and EMIs on the one hand and credit institutions (which include banks) on the other hand. Only the latter are permitted to take deposits of money and pay interest. EU law accords with English common law (*Foley v Hill* (1848) HLC 28 at 36 and 43-44) in relation to the fundamental principle of the banker-customer relationship, i.e. money deposited at a bank becomes the bank's own money and the customer's right to repayment is merely as a creditor (save in the case of a trust account).

3. By contrast, payment institutions and EMIs are not permitted to take deposits and are required to take steps to safeguard "*relevant funds*", i.e. sums paid by electronic money holders ("**EMHs**") to the EMI in exchange for e-money ("**Relevant Funds**"). The rules are set out in the Electronic Money Regulations 2011 ("**EMR**").

4. ipagoo became insolvent and was placed into administration in July 2019. It remains in administration and is prohibited from conducting any business. I was informed by Mr Jack Watson, counsel for the Administrators, that ipagoo received from EMHs Relevant Funds totalling €3,810,972, £235,854 and US$265,980, but that it has not proved possible to establish whether any of these funds were safeguarded as required by the EMR.

5. The Administrators' application asks:

    i) Do the EMR create a statutory trust of the "*asset pool*" as defined in Reg 24 of the EMR ("**Asset Pool**") for the benefit of EMHs? and

    ii) Do Relevant Funds which should have been, but were not, dealt with in accordance with Regs 20-22 form part of the Asset Pool?

6. The application also seeks further relief, but it was agreed that I would deal with these issues first. Mr Jason Baker, one of the Administrators, has provided a detailed witness statement, but it is not necessary to set out the facts in any greater detail, since the issues which I am currently considering involve pure points of law.

7. The FCA has intervened in these proceedings as *amicus curiae* at the Administrators' invitation. Dr Riz Mokal, who appears for the FCA, submits that a statutory trust arises in relation to Relevant Funds. The Administrators are neutral in relation to the issues set out above, but have presented the case against a statutory trust arising, in order that both sides of the argument are presented. I have been very much assisted by the written and oral submissions of both counsel.

8. During the course of the hearing I asked counsel to consider whether the mechanism for safeguarding EMHs' funds under the EMD and the EMR was by means of a charge rather than a trust. I raised this possibility because a number of features of the relevant Directives seemed to point towards EMHs having an interest by way of security. Neither party had originally contended for this result, but they helpfully provided written submissions.

## The correct approach to construing the EMR

9. The EMR were made in order to implement the Electronic Money Directive (2009/110/EC) ("**EMD**") and were expressed to be made pursuant to section 2(2) of the European Communities Act 1974. Accordingly the EMR constitute "*EU-derived domestic legislation*" and hence continue to have effect in domestic law by virtue of section 2(2) of the European Union (Withdrawal) Act 2018. By virtue of section 6(3)(a) of that Act it remains the case that they must be construed in accordance with "*retained case law*" and "*retained principles of EU law*".

10. Accordingly, notwithstanding Brexit, the court must follow the approach set out in *Lehman Brothers International (Europe) (In Administration)* [2012] 3 All ER 1 ("***Lehman***"). In that case, the Supreme Court had to construe Chapter 7 of the Client Assets Sourcebook (CASS 7). Lord Dyson said at [131]:

> "*It is not in issue that CASS 7 was made for the purpose of fulfilling the EU requirements contained in the Markets in Financial Instruments Directive 2004/39/EC ("MiFID") and the Commission Directive 2006/73/EC ("the Implementing Directive") and that CASS 7 should therefore be interpreted, as far as possible, so as to give effect to these Directives ... [T]his requires a two-stage test to be applied. The first involves interpreting the Directives. The second involves interpreting CASS 7 in the light of the meaning of the Directives. ... [D]omestic legislation which is made for the purposes of fulfilling the requirements of EU law contained in a Directive must be interpreted in accordance with the following principles: (i) it is not constrained by conventional rules of construction; (ii) it does not require ambiguity in the legislative language; (iii) it is not an exercise in semantics or linguistics; (iv) it permits departure from the strict and literal application of the words which the legislature has elected to use; (v) it permits the implication of words necessary to comply with Community law; and (vi) the precise form of the words to be implied does not matter.*"

11. Recital (3) in the Preamble to the EMD refers to the Payment Services Directive (2007/64/EC) ("**PSD1**"). PSD1 has been superseded by the Payment Services Directive (2015/2366/EU) ("**PSD2**"), and Art 114 of PSD2 states that any reference to PSD1 shall be construed as a reference to PSD2.

Thus before turning to the EMR I must first construe PSD2 and the EMD in the manner directed by Lord Dyson.

12. When looking at an EU Directive, the court may take account of the Recitals in the Preamble, which may cast light on the interpretation of the Articles (*Casa Fleischhandel v Bundesanstalt für Landwirtschaftliche Marktordnung* [1989] ECR 2789 at [31], ECJ).

**PSD2**

13. PSD2 distinguishes between credit institutions and payment institutions, as outlined above. Recital 34 provides that "*payment institutions should be prohibited from accepting deposits from users and should be permitted to use funds received from users only for rendering payment services*".

14. Recital 37 provides that: "*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.*"

15. Dr Mokal submitted that the reference in Recital 37 to "*payment services user funds*" suggests that payment service users ("**PSUs**") continue to have a proprietary interest in the money which they have paid in, in contrast to "*the payment institution's funds*". He pointed to the need for "*safeguarding*" requirements "*when*" (which he said means "*as soon as*") the payment institution is in possession of the payment users' funds; this suggests that protection is not dependent on the payment institution having taken the required steps to safeguard the funds.

16. He also drew my attention to several Recitals in the Preamble to PSD2, which refer to giving "*a high level of protection*" to consumer users of payment services. I do not think that I can derive much assistance from this, given that Recital 76 states that: "*to ensure a high level of consumer protection within SEPA* [the Single Euro Payments Area]*, the existing pan-European direct debt scheme provides for an unconditional right to a refund for authorised payments.*" This is an indication that PSD2 contemplates that the requisite high level of consumer protection may fall short of any proprietary rights.

17. Art 10 is headed "*safeguarding requirements*". So far as relevant it is in very similar terms to the equivalent Article in PSD1 and it provides as follows:

> "*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.*"

18. I note the following in relation to Art 10:

i) The use of the word "*shall*" makes it clear that the UK had a mandatory obligation to enact regulations in order to safeguard funds. The obligation relates to "*all*" funds received from PSUs for the execution of payment transactions, and sub-paragraph 1(a) states that the obligation provides that the funds shall not be commingled "*at any time*". These words point to the obligation arising at the moment when the PSU pays the funds to the payment institution, not at the moment when the payment institution complies with its safeguarding obligations.

ii) The opening words of 1(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*"), if read in isolation, suggest that Relevant Funds continue to belong to the PSU and may be mixed only with Relevant Funds belonging to other PSUs. By contrast, the reference in the second part of 1(a) to the claims of "*other creditors*" of the payment institution suggest that the PSUs are also creditors, who retain no proprietary interest in their Relevant Funds.

iii) Sub-paragraph 1(a) requires the payment institution either to deposit Relevant Funds in a separate account or to invest them in "*relevant assets*", i.e. secure, liquid, low-risk assets ("**Relevant Assets**"), and to ensure that they are "*insulated in accordance with the national law*" against the claims of other creditors, particularly in the event of insolvency. PSD2 therefore contemplates that each State may establish its own method of insulation in accordance with its domestic law. It would undoubtedly be possible to do so by creating a trust, but this provision does not specify that method of insulation.

iv) Sub-paragraph 1(b) provides an alternative method of safeguarding by means of an insurance policy or comparable guarantee. Mr Watson submitted that this alternative method was more consistent with a debtor-creditor relationship than with a trust.

v) Paragraph 2 deals with the situation where a payment institution pays money partly in order to buy payment services and partly in order to pay for other services. If the precise proportions are variable, the payment institution must make a reasonable estimate. Mr Watson says that this language also points to a debtor-creditor relationship, because the provision lacks the certainty needed for a trust.

vi) For the sake of completeness, I should add that points (1) to (6) of Annex 1 are activities which may require the payment institution to hold PSUs' funds.

**EMD**

19. Recital 11 to the EMD states that "*provision should be made for electronic money institutions to be required to keep the funds of electronic money holders separate from the funds of the electronic money institution for other business activities*." Dr Mokal submitted that this is an indication that the EMHs are to retain an interest in their Relevant Funds, although he accepted that the last four words which I have quoted make the position less clear.

20. Recital 13 states that the issuance of e-money does not constitute a deposit-taking activity and that *"electronic money institutions should not be allowed to grant credit from the funds received or held for the purpose of issuing electronic money. Electronic money institutions should not, moreover, be allowed to grant interest or any other benefit unless those benefits are not related to the length of time during which the electronic money holder holds*

*electronic money*." This confirms the distinction between credit institutions and EMIs, but it does not throw light on the issues which I must decide.

21. Recital 14 refers to the need for a level playing-field between credit institutions and EMIs, which should be achieved by balancing the less stringent regime applicable to EMIs 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*". This suggests that EMHs retain an interest in their Relevant Funds.

22. Article 6(3) provides that "*any funds received by electronic money institutions from the electronic money holder shall be exchanged for electronic money without delay. Such funds shall not constitute either a deposit or other repayable funds received from the public ....*" Mr Watson points out that "*exchange*" is the language of contract, not trust.

23. Article 7 is headed "*Safeguarding requirements*". The first sentence of paragraph 1 provides that: "*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 [PSD2 Art 10].*" The paragraph goes on to say that the duty to safeguard does not arise until the funds have been credited to the EMI, but that the funds must be safeguarded within five business days of the issue of the e-money.

24. Dr Mokal submits that the incorporation of safeguarding provisions of PSD2 into the EMD can only be for the purpose of protecting EMHs in accordance with PSD2. That must be right, but it begs the question as to what protection is given by PSD2. He accepts that the natural reading of the words "*that has been issued*" is that the duty to safeguard does not arise unless e-money is in fact issued to the EMH, but he submits (and I agree) that these words must be read together with Art 6(3), which requires the e-money to be issued "*without delay*".

**<u>EMR</u>**

25. The relevant Regulations of the EMR provide as follows:

> "*<u>2. Interpretation</u>*
>
> *"electronic money" means electronically ... 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 ...*

*20. Safeguarding requirements*

*(1) Electronic money institutions 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").*

*(2) Relevant funds must be safeguarded in accordance with either regulation 21 or regulation 22.*

*(2A) An electronic money institution may safeguard certain relevant funds in accordance with regulation 21 and the remaining relevant funds in accordance with regulation 22.*

*(3) 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.*

*(4) Funds received in the form of payment by payment instrument need not be safeguarded until they—*

*(a) are credited to the electronic money institution's payment account; or*

*(b) are otherwise made available to the electronic money institution,*

*provided that such funds must be safeguarded by the end of five business days after the date on which the electronic money has been issued.*

*(5) …*

*(6) [provision for non-electronic money funds received by EMIs.]*

*21. 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. ...*

*(5) The institution must keep a record of—*

*(a) any relevant funds segregated in accordance with paragraph (1);*

*(b) any relevant funds placed in an account in accordance with paragraph (2)(a);*

*(c) any relevant assets placed in an account in accordance with paragraph (2)(b) ...*

*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.*

*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 … 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); …*

*(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).*

*39. Issuance and redeemability*

*An electronic money issuer must-*

*(a) on receipt of funds, issue without delay electronic money at par value; and*

*(b) at the request of the electronic money holder, redeem-*

*(i) at any time; and*

*(ii) at par value,*

*the monetary value of the electronic money held.*

*40. Conditions of redemption*

*An electronic money issuer must ensure-*

*(a) that the contract between the electronic money issuer and the electronic money holder clearly and prominently states the conditions of redemption ...*

*72. Right to bring actions*

*(1) A contravention ... of a requirement imposed by regulation 20, 21, 22 or 24 ... is actionable at the suit of a private person who suffers loss as a result of the contravention ....*"

**The submissions for the benefit of unsecured creditors**

26. Mr Watson submitted that the EMR define the relationship between the EMI and the EMHs in contractual language, e.g. the definition of e-money as "*a claim on the electronic money issuer*" and the reference to "*contract*" in Reg 40. Further, neither the EMR nor the European Directives which they implement, make any reference to a trust. Although the absence of any express trust is not conclusive, it is a pointer.

27. The specific safeguarding provisions in Regs 20-22 are contractual and do not confer any proprietary interest on EMHs. He points to the imprecise language of Reg 20(3) ("*reasonably estimated*" and "*representative*"), to the choice given to the EMI whether to follow Reg 21(2)(a) or (b) or Reg 22, to the fact that the EMHs have no right to the interest or dividends earned on Relevant Funds or Relevant Assets under Reg 21(2)(a) or (b), and to the fact that the alternative insurance option in Reg 22 appears to confer no rights in the insurance policy prior to insolvency.

28. Reg 24 treats EMHs as having rights as creditors in respect of the Asset Pool. This is inconsistent with them having any beneficial interest in the Asset Pool.

29. He also submits that the Asset Pool does not include Relevant Funds which ought to have been, but have not been, safeguarded under Regs 20-22. Such money is therefore divisible among all the unsecured creditors, including EMHs.

30. He adds that the draftsman did contemplate the possibility that an EMI might fail to comply with Regs 20-22, since this is dealt with in Reg 72, which provides a statutory remedy for non-compliance. That remedy would be unnecessary if EMHs had a beneficial interest in the Relevant Funds.

31. The EMR comply with the UK's obligation to impose regulations in conformity with PSD2 and the EMD. It is unfortunate for EMHs that they are left unprotected in the event of an EMI failing to fulfil its obligations under Regs 20-22, but that does not mean that the UK has fallen short of its obligations. There is therefore no basis for reading words into the EMR.

32. In written submissions sent to me after the hearing Mr Watson added that there was no legal difficulty in concluding that the EMR override the rules of priority for distribution of assets upon insolvency, and he pointed to the Insurers (Reorganisation and Winding-up) Regulations (SI 2004/53) and the Regulated Covered Bonds Regulations (2008/346) as examples of Regulations which expressly have that effect. However, he submitted that there would be very substantial difficulties in identifying the Relevant Funds which have not been duly safeguarded, unless the EMR give the EMHs effectively a security interest over all the assets of the EMI.

**<u>The submissions for the benefit of the EMHs</u>**

33. Dr Mokal submitted that the correct starting-point is PSD2 and the EMD, which the EMR are intended to implement. The EMR must be construed so as to give effect to these Directives.

34. Recital 37 and Art 10 of PSD2 make it clear:

    i) that Relevant Funds are to be protected at all times (i.e. whether or not the EMI has complied with its obligations under Regs 20-22 of the EMR); and

    ii) that the nature of the protection requires the imposition of a trust in order to give effect to it under English law.

    I interpose to say that in my judgment these are distinct submissions. It is logically possible to accept the first without the second.

35. The EMD are to be read together with PSD2. The absence of any reference to trusts is not surprising, given that trusts do not feature in EU law, but Dr Mokal highlighted words and phrases in PSD2, the EMD and the EMR which he says are more consistent with a trust than with a debtor-creditor relationship. (I have set out the principal examples above.)

36. He submitted that Relevant Funds and Relevant Assets are therefore held on trust for all EMHs, in much the same way as money held by a solicitor in a general client account is held on trust for all clients, despite the absence of segregation between different clients' moneys. However, this is subject to Rule 39, which expressly entitles the EMI to retain any interest or dividends. As regards Reg 22, his initial submission was that a trust over the proceeds of the insurance policy arises only upon insolvency, but he subsequently submitted that there is also a trust over the policy itself.

37. He quoted Lord Diplock in *Ayerst (Inspector of Taxes) v. C&K Construction) Ltd* [1975] AC 167, who said at 180E-F that the effect of winding up a

company was "*to give the property of the company in liquidation that essential characteristic which distinguished trust property from other property, viz that it could not be used or disposed of by the legal owner for his own benefit, but must be used or disposed of for the benefit of other persons*". He submitted that this distinguishing characteristic is imposed by PSD2 and the EMD, and that the EMR must therefore be read as creating a trust.

38. In this context he also referred to *Henry v Hammond* [1913] 2 KB 515, in which Channell J said at 521:

> "*It is clear that if the terms on which the person receives the money are that he is bound to keep it separate, either in a bank or elsewhere, and to hand that money so kept as a separate fund to the person entitled to it, then he is a trustee of that money and must hand it over to the person who is his cestui que trust. If on the other hand he is not bound to keep the money separate, but is entitled to mix it with his own money and deal with it as he pleases, and when called up to hand over an equivalent sum, then, in my opinion, he is not a trustee of that money, but merely a debtor*."

39. He also relied on *Lehman*. That decision concerned CASS 7, which had been enacted in order to give effect to MiFiD (see paragraph 10 above). MiFid did not expressly create a trust, but CASS 7 did so. The trust was expressed to take effect upon segregation of assets, but the courts held that it took effect upon receipt of money by the firm, whether or not there had been segregation as required.

40. I agree that *Lehman* is of assistance in two respects: firstly for Lord Dyson's guidance as to how to construe domestic regulations in the light of EU Directives, and secondly as an example of a case in which the clear purpose of the Directives required that the protection afforded by the domestic regulations should commence at the moment of receipt and not await the act of segregation by the firm. However, in my judgment *Lehman* does not assist in determining whether any trust arises in the present case, given that the EMR, unlike CASS7, do not expressly impose a trust.

41. He also referred to *Re Supercapital Ltd* [2020] EWHC 1685 (Ch), a decision of Deputy ICC Judge Agnello QC. The provision with which she was concerned was Reg 23 of the Payment Services Regulations 2017, which was made pursuant to Art 10 of the PSD2 and has some similarities with the EMR. She said at [9]:

> "*In Lehman, the Court of Appeal considered the provisions under CASS 7 which made an express declaration of trust, but did not, as set out by Lady Justice Arden, thereafter provide any further provision as to the operation of the trust. Trust law will be used to enable such trusts to be operated for the benefit of the beneficiaries. In relation to the PSR, [counsel] informed me that to date, there has been no case which has considered the rules in relation to the PSRs and whether the provisions, the relevant extracts of which I have set out above, create a statutory trust. There are in my judgment, many similarities as between the PSRs and CASS 7, save that*

*CASS 7 makes an express declaration of trust. That in in itself of course is not determinative, merely an indication that many of the provisions set out in the PSRs are those one would expect to see in the event that a statutory trust is created.*"

After analysing the relevant Regulation, she concluded at [10]:

"*In my judgment, taking all the regulations I have set out above into account, I am satisfied that the PSRs create a statutory trust. All the characteristics for such a trust being in existence are present. The segregation of funds received right from the inception as well as ensuring that they are identifiable is equally important. The fact that the company cannot use the funds in its own business and the position is made clear that the funds are only available to those beneficiaries in the event of an insolvency event are also important. In the circumstances, the Administrators are correct in their approach to treat the funds as being held by way of a statutory trust.*"

However, it appears that she did not have the benefit of hearing submissions to the contrary.

42. I asked counsel to consider the impact of the Third Parties (Rights Against Insurers) Act 2010. This provides, in the case of liability insurance, that the rights of the insured against his insurer are assigned automatically to the person who has a claim against the insured, in the event of the insured's insolvency. Dr Mokal submitted that it was not clear whether the insurance referred to in Reg 22 would be liability insurance and he therefore submitted that the impact of the 2010 Act should not be determined in the present proceedings. Mr Watson agreed with that approach. I will leave this question to be determined in a case in which it arises directly.

43. In written submissions sent to me after the hearing Dr Mokal referred me to extracts from Chapter 5 of *Lowe & Potter: "Understanding Legislation: A Practical Guide to Statutory Interpretation*" and said that there was no basis in the EMR for implying into Reg 24 that it overrode the usual priority rules for distribution on insolvency. He noted that Reg 24A and Schedule 2ZA to the EMR expressly modify the Banking Act 2009 and submitted that the same would have been the case, had the EMR been intended to modify the priority rules.

44. I have given careful consideration to these written submissions, but in my judgment:

    i) The passages to which I was referred do not deal with the situation considered by Lord Dyson in *Lehman* (see paragraph 10 above); and

    ii) Considerably greater re-writing would be needed if I were to conclude that PD2 and the EMD required the EMR to be construed as giving rise to a trust.

## **Discussion**

***Do the EMR impose a statutory trust?***

45. The salient features of the EMR relating to safeguarding are as follows:

    i) All Relevant Funds are to be safeguarded by means of one of two safeguarding options.

    ii) Option 1 requires that Relevant Funds be segregated immediately from any other funds held by the EMI. Where the EMI continues to hold Relevant Funds at the end of the next business day, it must either place these funds in a separate account with a credit institution (typically a bank) or invest them in Relevant Assets. There is no requirement to segregate the funds of different EMHs from one another. Reg 39 entitles an EMH to redeem the monetary value at any time at par value; the effect is that any interest or dividends belong to the EMI (in accordance with EMD Recital 13: see paragraph 20 above).

    iii) Option 2 requires that Relevant Funds be "*covered*" by an insurance policy or guarantee which is payable upon an insolvency event. The proceeds must be paid into a separate account and may be mixed only with Relevant Funds or Assets held under Option 1.

    iv) Reg 24 provides for the claims of EMHs to be paid from the Asset Pool (defined by reference to Regs 21 and 22) "*in priority to all other creditors*".

46. There are undoubtedly features of the EMR which are consistent with a statutory trust, in particular the following:

    i) Under Option 1 the EMI is required either to keep the Relevant Funds in a separate bank account or to invest them separately from other funds. The fact that the funds of all EMHs may be held in a single segregated account is not inconsistent with a trust. A well-known example of such a trust is a solicitor's general client account.

    ii) Upon the insolvency of the EMI, the EMHs are paid out of the Asset Pool which comprises (i) the very same Relevant Funds that were held in the separate bank account or were invested in Relevant Assets and/or (ii) the proceeds of the insurance policy.

47. Conversely, there are other features which are less easy to fit into a trust framework, in particular the following:

    i) As the EMHs spend the e-money which they received in exchange for Relevant Funds, the EMI's obligation to retain and safeguard the Relevant Funds or Relevant Assets diminishes at the same rate, leaving the EMI entitled to spend any surplus.

ii) Option 1 is likely to result in a small amount of interest or dividends. In the case of a conventional trust, one would expect the beneficiary to enjoy any such interest or dividends, but Reg 39 provides otherwise.

iii) EMH may at any time choose to redeem their e-money at par value. There is no requirement that the EMH should be paid out of Relevant Funds or Relevant Assets.

iv) Where a customer pays money for two purposes, only one of which is for the purchase of e-money, Reg 20(3) requires the EMI to make a reasonable estimate. This lacks the certainty usually associated with trusts.

v) If the EMI chooses Option 2, it will purchase an insurance policy to "*cover*" the Relevant Funds. There is no requirement that the policy be bought with Relevant Funds. To the extent that the EMH is protected by the policy, the EMI is permitted to spend the Relevant Funds.

48. Although PSD2 and the EMD contain features which are consistent with a trust or a charge, there is nothing which points unequivocally to a trust or charge. In *Henry Hammond* (see paragraph 38 above) Channell J drew a dichotomy between a bare trust and a personal obligation to repay the equivalent sum. However, in my judgment PSD2 and the EMD contemplate a relationship which lies somewhere between these two extremes. It would be putting the cart before the horse to say that this amounts to a trust and then to ascribe to it all the features which flow from it being a trust.

49. Regs 20-22 and 24 of the EMR achieve the level of protection required by these Directives, subject only to the question of the status of Relevant Funds where the EMI has failed to comply with Regs 20-22. There is no basis for implying a trust (nor, for that matter, a charge). To the contrary, the imposition of a trust or charge would at best duplicate Reg 24, and at worst conflict with it.

50. In *Lehman* at [186] Lord Collins referred to the report of Professor Gower which preceded the Financial Services Act 1986. The report noted that under English law mere segregation of assets is not enough to protect clients' funds from the firm's general creditors in the event of the firm's insolvency, and that clients' money could be safeguarded by segregation only if there was a trust. However, this conclusion does not apply in the present case, because protection in the event of insolvency is expressly conferred by Reg 24.

51. If Reg 24 is to be given its full effect, it must override the priority rules which would otherwise apply to the distribution of assets upon the EMI's insolvency. Were it not for the existence of PSD2 and the EMD¸ I would have been more troubled as to whether Reg 24 could properly be said to have overridden the usual priority rules on the distribution of assets on insolvency, especially given that the EMR did expressly override the Banking Act. However, in reliance on the dictum of Lord Dyson in *Lehman* (paragraph 10 above) I am satisfied

that this is permissible, and indeed required, in order to give proper effect to PSD2 and the EMD.

***<u>Do all Relevant Funds form part of the Asset Pool?</u>***

52. Art 10 of PSD2 required the UK to ensure that a high level of protection is given to EMHs in respect of Relevant Funds. The obligation relates to "*all*" Relevant Funds, and the prohibition on commingling Relevant Funds with other funds of the EMI is "*at any time*". In my judgment this required the UK to make regulations giving the same level of protection to Relevant Funds whether or not the EMI had complied with Regs 20-22.

53. Mr Watson submitted that there would be very substantial difficulty in identifying Relevant Funds where they had been mixed with the EMI's other funds. I see the potential difficulty, but it should not arise in practice, in view of my conclusion that the protection given to EMHs is not proprietary in nature. In my judgment, the protection does not extend to the actual Relevant Funds which have not been safeguarded, but extends to an equivalent sum.

54. I conclude that, in order to comply with Art 10 of PSD2, it is necessary to treat the Asset Pool in Reg 24 as including a sum equal to all Relevant Funds which ought to have been, but have not been, safeguarded under Option 1 or Option 2. Once again, I rely on the dictum of Lord Dyson in *Lehman* in reading these words into Reg 24.

55. The consequence is that any office-holder who is tasked with distributing the assets of an insolvent EMI must consider, before distributing the assets, whether the EMI received Relevant Funds which should have been, but were not, safeguarded under Regs 20-22. If so, a sum equal to those Relevant Funds assets must be added to the Asset Pool and distributed in accordance with Reg 24 in priority to any other distributions.

**<u>Disposal</u>**

56. For the reasons set out above:

    i) Regs 20-22 and 24 of the EMR do not create a statutory trust in favour of EMHs but give a statutory right for EMHs to be paid out of Relevant Funds in priority to all other creditors on the terms set out in Reg 24; and

    ii) The definition of Asset Pool in Reg 24 includes a sum equal to any Relevant Funds which should have been, but were not, safeguarded under Regs 20-22 by means of Options 1 or 2.

57. Because this judgment is being given on the last day of term and because there has not been time to agree an order or to deal with the remaining matters in the Application, I will formally adjourn the hearing under CPR r 52.3(2)(a) to the

hearing of the remaining parts of the Application and I will extend time under r. 52.12(2)(a) to run from the date of the adjourned hearing.