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Case No: CR-2023-001772

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
INSOLVENCY AND COMPANIES LIST

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

Date: 4 October 2024

Before :

MR JUSTICE RAJAH

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IN THE MATTER OF WEALTHTEK LLP (IN SPECIAL ADMINISTRATION)

AND IN THE MATTER OF THE INVESTMENT BANK SPECIAL ADMINISTRATION REGULATIONS 2011

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- -

Daniel Bayfield KC and **Paul Fradley** (instructed by **Norton Rose Fulbright LLP**) for the **Applicant**

Hearing dates: 7 June and 23 July 2024

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APPROVED JUDGMENT

Mr Justice Rajah :

Introduction

1. WealthTek LLP ("**WealthTek**") is an investment bank within the meaning of section 232 Banking Act 2009. Until it was placed in administration it offered discretionary management, advisory and execution-only services to predominantly retail clients. It was the subject of an intervention by the Financial Conduct Authority ("**FCA**") on the basis that the FCA suspected criminal activity and that WealthTek was operating outside of its regulatory permissions. On 4 April 2023, joint interim managers were appointed by the Court and on 6 April 2023 an investment bank special administration order was made by the Court under the Investment Bank Special Administration Regulations 2011 ("**the IBSA Regulations**"). There were significant shortfalls in the assets and money which should have been held by WealthTek for its clients when it went into special administration.

2. Shane Crooks, Mark Shaw and Emma Sayers of BDO LLP have applied in their capacity as the joint special administrators of WealthTek LLP ("**the Administrators**") for approval by the Court of a distribution plan in respect of approximately £148m of stocks and shares or other client assets ("**Client Assets**") held for approximately 1320 clients by WealthTek ("**the Distribution Plan**"). 98% of those clients are individual retail clients with an average age of 68. There is a shortfall of approximately £70.6m in these holdings between what is there and what should be there. There is also cash of approximately £2.7m held on accounts for clients ("**Client Money**"). There is a shortfall of approximately £10m in this client money between what is under the control of the Administrators and what should be there. There is a proposed retention of £18.4 million for the costs of returning Client Assets and a retention of just under 2% of Client Money for the costs relating to the return of client money. The proposed retention includes a proposed reserve of 7,168,218 ("**the Potential Litigation Reserve**") representing the estimated costs of potential litigation to recover some of the shortfall in assets from third parties.

3. For many of these clients, the sums held by WealthTek represented their pensions or life savings. I have seen a number of letters, many sent directly to the Court, which

leaves me in no doubt as to the loss of financial security, and the mental, emotional and financial hardship, caused by the shortfall between what clients should have had and what can now be returned to them under the Distribution Plan. Those letters highlight a sense of injustice felt by some clients at the perceived failure by any regulatory body to prevent the activity giving rise to the shortfalls and a sense of injustice that the costs of returning the assets and money (a proposed £23000 per head) are using up part of the Financial Services Compensation Scheme Ltd ("**FSCS**") compensation which would otherwise be available to meet the shortfalls. They also convey the unhappiness of clients that it has taken over a year for the Administrators to make this application for Court approval and the hardship that is being caused by further delay in distributing the assets held by WealthTek. I have taken into account these sentiments as part of the background to the application I am dealing with, but I am not in a position to decide whether they are justified.

4. The FSCS believes that most of the clients will be eligible for FSCS compensation up to a cap of £85000. It estimates its exposure at approximately £40m in meeting all of the proposed £18.4m of costs of administering and returning client money and assets and approximately £22m in respect of the shortfalls in assets available to be returned and the costs. Nevertheless some 21% of clients have shortfalls so large that with their share of the costs of returning assets, the cap of £85000 will be exceeded and they will be out of pocket, some significantly so. The FSCS calculates that 4% of clients have shortfalls between £62000 and £85000 while 17% have shortfalls in excess of £85000.

5. The Distribution Plan has been formulated by the Administrators having regard to the Investment Bank Special Administration (England and Wales) Rules 2011 ("**the IBSA Rules**"). It was developed in consultation with the FCA and FSCS and it has been approved by WealthTek's creditors committee ("**the Committee**"). The Committee was nominated and selected at the initial meeting of creditors and clients to represent the interests of all of WealthTek's creditors and clients. The Committee comprises 4 clients and the FSCS.

6. In summary (subject to the payment of costs and the discharge of any security interests), the Distribution Plan will enable clients to access their assets via either a

transfer to a nominated broker or by an alternative mode of distribution (a transfer to a different broker, the liquidation of the assets or the actual return of physical share certificates). Save for dividends and income which has accrued on Client Assets since the appointment of the Administrators, the Distribution Plan does not deal with Client Money. Client Money will be returned by the Administrators in accordance with the relevant rules of the FCA's Client Asset Sourcebook in a process that will run in parallel to the return of Client Assets.

7. In determining what assets and money belong to each client for the purposes of the Distribution Plan, the Administrators have found the books and records of WealthTek to be unreliable and with significant discrepancies and mismatches. The Administrators have conducted a reconciliation exercise with the benefit of legal advice to arrive at a reconciliation which is commercial, robust and as legally sound as it can be. They acknowledge, however, that even if their legal advice is right a practical approach requires them to make a determination of some issues which does not strictly accord with the rights of the affected clients.

8. At the first hearing of the application on 7 June 2024, I was told that this was the first time that a distribution plan under the IBSA regime proposed a distribution which was not in line with the administrator's understanding of the rights of the client. Moreover, although the Distribution Plan has a procedure for referring to the Court disputes between the Administrators and clients over claims to Client Assets, that referral procedure does not extend to disputes over the correctness of the reconciliation exercise. As Mr Bayfield put it, the reconciliation exercise is "baked in" to the Distribution Plan. The Administrators maintained that allowing challenge to the reconciliation exercise would render the Distribution Plan unworkable. At the first hearing on 7 June 2024 the approach taken by the Administrators was also that the legal advice received by them, including a joint opinion from Mr Bayfield and Mr Fradley, was privileged and requests by clients to see it were refused (an approach which is questionable in circumstances where the advice was to determine each beneficiary's interest in the trust assets, was being paid for from the trust funds, and is arguably therefore a trust document). The legal advice was not produced to the Court. Instead, the Court was invited not to consider the correctness of the Administrators'

proposed approach to the reconciliation exercise and to accept that the Administrators considered (and the Committee agreed) that the approach proposed was in the interests of clients generally.

9. This did not seem to me to be the right approach. The Court's approval of a distribution plan is a key safeguard of client interests under the IBSA regime. The Court has to be satisfied that the proposed plan is fair and reasonable. The test is not whether the Court is satisfied that that the Administrators (and Committee) think it is fair and reasonable. Clearly the administrator in a special administration will not put forward a scheme which the administrator does not think is fair and reasonable and the Court will have appropriate regard to the views of the administrator and the creditors' committee. The ISBA regime nevertheless requires the Court's approval as a cross check as to whether it is in fact so.

10. The application was therefore adjourned for a review of the reconciliation exercise by independent counsel on behalf of the beneficiaries, and for further submissions by the Administrators on whether the Court has jurisdiction to and should approve a Distribution Plan which does not conform to the strict rights of clients in and to the Client Assets.

11. By the second hearing on 23 July 2024, Mr Matthew Weaver KC had been instructed by the Administrators on the basis that his primary and overriding duty was to be to the Court and to consider the Distribution Plan from the perspective of the beneficiaries of it. Had there been more time to organise it, I would have preferred Mr Weaver to have been instructed by a representative client or the Committee, albeit on the basis that the costs of the exercise would be paid by the Administrators as part of the costs of the application. The joint Opinion of Mr Bayfield KC and Mr Fradley was provided to Mr Weaver. A copy of Mr Weaver's Opinion was provided to me in advance of the hearing on 23 July 2024 and he attended at the hearing on 23 July 2024 to address its contents.

12. I approved the Distribution Plan on 23 July 2024, except in relation to the Potential Litigation Reserve. This judgment sets out my reasons for concluding that the Court

has jurisdiction to and should approve this Distribution Plan even though it does not conform to the strict rights of clients in and to the Client Assets.

13. I received written submissions after the hearing on 23 July 2024 on whether the Court has jurisdiction to and should approve the Potential Litigation Reserve. This judgment also sets out my decision on the proposed Potential Litigation Reserve.

A bare trust for each client

14. The Administrators accepted, and this application has proceeded on the basis that, the Client Assets are held by WealthTek on bare trust for each client.

15. The terms of an express trust are usually governed by the trust instrument. In this case, the trust instruments are the contracts between WealthTek and each client. There has been no examination of the underlying contracts during the course of this application, and while I have been told they may have provided in some cases for discretionary management of the trust fund, and contained other administrative powers, I have seen nothing to suggest that there is anything other than a bare trust here whereby WealthTek held each client's part of the Client Assets and Client Money on bare trust for that client. Mr Bayfield accepted that.

16. A bare trust is one in which the trustee holds the trust fund for a beneficiary absolutely. The beneficiary is the beneficial owner of the trust fund and has the right to wind up the trust and call for the transfer of the trust fund to the beneficiary (or to someone else at the beneficiary's direction). The trustee has no true discretion as to whether to retain or return the trust fund if it is demanded - it is the trustee's duty to return the trust fund. That said, where there are competing proprietary claims, undischarged present or contingent liabilities, uncertainty as to the nature of the underlying interests or some other complication, the trustee may be justified in temporarily retaining the assets pending resolution of those issues. Absent such complications the trustee cannot, as a matter of trust law, withhold the trust fund from the beneficiary against the beneficiary's wishes.

17. It is the trustee's duty to account to the beneficiary for the trust fund, and if there is a shortfall between what is there and what should be there, the trustee is personally liable

to make good the shortfall. If loss has been caused to the trust fund by the actions or inactions of the trustee, the trustee may also be personally liable for breach of an equitable duty to exercise skill and care. If the trustee has distributed the trust fund to the wrong person, the trustee is personally liable to reinstate the trust fund and pay it to the true beneficiary.

18. These principles of trust law are capable of modification by statute and delegated legislation. To some extent this has happened with the IBSA regime.

The IBSA regime

19. The IBSA Regulations deal (amongst other things) with specific issues arising in investment bank insolvencies, which are not capable of being dealt with as a matter of trust law or under the administration process for ordinary companies set out in Schedule B1 to the Insolvency Act 1986 (***the Insolvency Act***).

20. The modified administration regime under the IBSA Regulations was introduced in 2011, following the collapse of Lehman Brothers in 2008 and the difficulties experienced in that administration, including the practical and legal obstacles to the swift return to clients of client assets held on trust in the absence of some mechanism for overriding the strict rights of beneficiaries and exonerating trustees from liability. The problems included:

    a. protecting the beneficiaries and trustees from late claims materialising after distribution;
    b. provision for the costs of administering the return of such assets; and
    c. identifying each client's interest in omnibus accounts at the bank when there was a shortfall in those accounts.

21. In the Lehman Brothers administration – an administration under Schedule B1 to the Act – the administrators had experienced difficulties in each of these respects which could not be overcome as a matter of trust law, or by a scheme of arrangement due to the limitations of the scheme jurisdiction. A creditor scheme of arrangement under Part 26 of the Companies Act 2006 (***the Companies Act***) must be an arrangement between the company and its creditors which varies the creditors' existing creditor rights and

concerns their position as creditors: *Re Lehman Brothers International (Europe)* [2010] 1 BCLC 496 at [63]-[66].

22. Mr Justice Blackburne, whose judgment in *Lehman Brothers* was upheld by the Court of Appeal, accordingly held that the Court had no jurisdiction to sanction a scheme of arrangement proposed by the company to vary the proprietary entitlements of clients in respect of assets which the company held on trust for those clients.

23. In response to the problems encountered in Lehman Brothers – specifically, the desire for a certain and speedy return of assets which vests good title and which allows costs to be defrayed and any claims for loss quantified – legislative intervention was required. The IBSA Regulations (and IBSA Rules) constitute that intervention.

24. Under the IBSA Regulations, the Court appoints one or more administrators to pursue the special administration objectives in accordance with a statement of proposals that is approved by a meeting of creditors and clients, and in certain circumstances, the Financial Conduct Authority ("**FCA**") or Prudential Regulation Authority ("**PRA**"). In other respects, the ordinary rules to an administration under Schedule B1 of the Insolvency Act 1986 apply with certain modifications.

25. Regulation 10 provides that a special Administrator has three special administration objectives. Objective 1 is "*to ensure the return of client assets as soon as is reasonably practicable*". In relation to Objective 1:
    a. Regulation 10B(13) defines "*client assets*" as (1) "*assets which an institution has undertaken to hold for a client (whether or not on trust and whether or not that undertaking has been complied with*)" (by reference to the meaning which the term has in section 232(4) of the Banking Act 2009) and (2) assets equivalent to those which the institution has undertaken to hold.

    b. The term "*client*" is defined in Regulation 2(1) as "*a person for whom the investment bank has undertaken to receive or hold client assets (whether or not on trust and whether or not that undertaking has been complied with)*."

c. "*Return*" in context has a broad meaning under Regulation 10(5): "*the investment bank relinquishes full control over the assets for the benefit of the client to the extent of … the client's beneficial entitlement to those assets (where the assets in question have been held on trust by the investment bank) … having taken into account any entitlement the investment bank may have, or a third party might have, in respect of those assets*." In addition, section 233(4) of the Banking Act 2009 makes clear that a reference to returning client assets includes a reference to *"(a) transferring assets to another institution, and (b) returning or transferring assets equivalent to those which an institution undertook to hold for clients*".

26. Objective 2 is to ensure timely engagement with market infrastructure bodies and the Bank of England, HM Treasury, the FCA and the PRA. Objective 3 is to either rescue the investment bank as a going concern or wind it up in the best interests of its creditors.

27. The application for court approval of the Distribution Plan is only concerned with Objective 1.

28. If the administrators think it is necessary in order to achieve Objective 1, Regulation 11(1) allows them to set a bar date for the submission within a reasonable time of: (i) claims to the beneficial ownership, or other form of ownership, of client assets; or (ii) claims of persons in relation to a security interest asserted over, or other entitlement to, those assets. This is known as a "soft bar date". The purpose of a soft bar date is to allow the administrators to establish the universe of claimants interested in the distribution of the client assets. On 12 February 2024 the Administrators set an initial soft bar date of 20 March 2024. Once the administrators have set a soft bar date, no client assets may be returned except in accordance with a distribution plan approved by the Court. Claims made after the return of assets pursuant to such a court approved distribution ("**late claims**") will not disturb the prior return of client assets.

29. Such a return gives good title (although there are exceptions for bad faith). The effect is therefore to interfere with the beneficial entitlements of any other client who may have a competing claim to the assets distributed. The purpose of the mechanism is to

"*to give certainty to clients who receive back their assets that they will not be challenged at a later date by a third party for the return of those assets*": Explanatory Memorandum to the IBSA Regulations, para 7.12.

30. Regulation 12B permits an administrator to apply to the Court, having set a soft bar date, for permission to set a hard bar date after which any late claims to client assets will be extinguished (save for an entitlement to certain residual assets) and the value of any such claims will rank instead as an unsecured claim in the administration estate. The hard bar date, if set, has the effect of entirely extinguishing the beneficial interest in client assets of clients who make late claims. Regulation 12C contains a similar hard bar date mechanism for client money.

31. The IBSA Regulations are supplemented by the IBSA Rules which set out provisions as to how a distribution plan under the IBSA Regulations is to be formulated. In respect of client assets over which there is no security interest exerted by a third party or the investment bank Rule 144 provides:

> "144.— Distribution plan
> …
> (2) The administrator shall draw up a distribution plan setting out—
> (a) subject to paragraph (3), a schedule of dates on which the client assets are to be returned ("a distribution");
> (b) the unencumbered assets to be returned and to whom;
> …
> (e) the amount and identity of client assets that are to be retained by the administrator to pay the expenses of the special administration in accordance with rules 135 and 137 and how the retention of these assets will affect the amount of client assets to be returned to clients.
> (3) In setting out the schedule of dates for the return of the client assets, no date shall be sooner than the date which is 3 months after the bar date.
> …"

32. Rule 146 sets out the power of the court to approve a distribution plan. Provided the necessary notifications have been given pursuant to Rule 143, and the creditors' committee has either approved the distribution plan or been heard on why it has not, then the Court has an unfettered discretion whether to approve the distribution plan or make some other order. Subsequent case law has made clear that the discretion will be

exercised taking into account the purpose of the distribution plan under the IBSA Rules, which is to assist in the achievement of Objective 1 of returning client assets soon as is reasonably practicable and the court will want to be satisfied that the plan provides a fair and reasonable means of effecting the distribution of the client assets to which the plan relates; see *Re SVS*, at paragraphs 32 to 34.

Jurisdiction to approve a Distribution Plan which does not conform to the strict rights of clients in and to the client assets

33. It is clear that the IBSA regime is intended to override trust law to permit the special administrators to fulfil the special administration objective of returning client assets as soon as possible. The IBSA Rules require the administrators to prepare a distribution plan setting out what assets are to be returned, to whom and when, and what retention is to be made for costs. The IBSA Regulations and Rules do not attempt to prescribe on what basis the administrators should decide what assets are to be returned or to whom. That distribution plan is subject to the Court's approval and the rules place no fetter on the Court's discretion to approve or not approve. Approval has the effect of conferring good title on those who receive a distribution in accordance with the plan. The IBSA Regulations do not stipulate that the plan must give effect to each client's proprietary rights. As illustrated by the soft and hard bar date procedures, the IBSA regime overrides proprietary rights in the interests of achieving Objective 1. Were it to treat proprietary interests as sacrosanct its fitness for purpose would be undermined, for example in situations where the bank's records do not identify who the assets belonged to, or there are shortfalls in total assets and it is not clear how the assets should be distributed.

34. It is not surprising, therefore, that there is no requirement in the IBSA Regulations or the IBSA Rules for the distribution plan proposed to be one which accords with the rights of the clients. The clients are protected, inter alia, by the fact that the distribution plan: (a) will be proposed by administrators, who are officers of the Court; (b) will be considered by the creditors' committee and made available to all of the clients of the investment bank, and (c) must be approved by the Court. So far as Court approval is concerned, plainly a plan which ran roughshod over the rights of clients without good

reason would not be fair and would not be reasonable. In many cases, therefore, the purpose of the distribution plan will be "*to make a distribution of assets in accordance with clients' proprietary rights and pursuant to Objective 1, not to interfere with or alter those rights*" as HHJ Keyser QC observed (obiter) in *Re Hume Securities PLC* [2015] EWHC 3717 (Ch), where none of the sorts of practical difficulties faced by the Administrators in this case were present. In an appropriate case, however, rule 144 permits the administrator to draw up a distribution plan setting out the unencumbered assets to be returned and to whom, but which does not accord with the strict rights of the clients. The Court will only approve that plan if it is satisfied that it is nevertheless a fair and reasonable means of effecting the distribution of the client assets to which the plan relates.

Reconciliation exercise

35. The Administrators have established that WealthTek's books and records are not accurate. They have identified a number of recurring problems in relation to many clients which create uncertainty as to the identification of what assets now belong to each client.

36. At the time of the Administrators' appointment, WealthTek was holding a number of physical share certificates in the name of clients which were due to be dematerialised and sold, and the net sale proceeds credited to the client's cash account with WealthTek and held as client money. This gives rise to questions as to whether the clients are still entitled to the shares or to any increased client money entitlement ("**CME**") they have received, any client money actually withdrawn based on the increased CME, and/or any new Client Assets purchased with the increased CME.

    a. The Administrators have discovered that there are significant discrepancies between WealthTek's holdings of Client Assets for a client as recorded in: (i) accounts within WealthTek's books and records, and (ii) WealthTek's accounts held with a third-party custodian. In effect, there are mismatches between account designations recorded in the books and records of WealthTek and the custodian's records; there are also discrepancies in the amount of Client Assets recorded as being held in particular accounts.

b. At least two gratuitous payments have been made to a client from the client money account but have not been reflected in a client's CME.

c. In some cases, it seems WealthTek had sold a Client Asset (paying the actual proceeds into the client money account) but had not recorded this in the books and records and continued to pay "manufactured dividends" to the client.

d. In some cases, within (c) above, the client subsequently instructed WealthTek to sell the original asset (which had in fact already been sold) and purchase a new one. That new asset was then purchased from mixed funds.

e. In yet other cases, a client instructed WealthTek to sell a Client Asset, WealthTek failed to do so but then credited the client with an increased CME.

37. The Administrators took the view that the determination of these issues by the Court with the benefit of assumed fact patterns and representative clients would be contrary to Objective 1 and I agree. It would have been an expensive and time-consuming process, with scope for appeals, reducing the value of the Client Assets which could be returned (because the costs would have been payable out of the Client Assets) and delaying the return of the Client Assets available for return.

38. The Administrators have, with the benefit of legal advice, including a joint opinion of Mr Bayfield KC and Mr Fradley, taken what they describe as a "robust, commercial approach" in establishing what rights each client has in the assets and that "it is appreciated that, where contrary positions are arguable, there will be winners and losers". The Administrators accept that in relation to the fifthand final scenario in 32(e) above what they propose to do, does not conform with the strict rights of clients because of the practical difficulties in adopting any different approach. In such cases, the affected clients would ordinarily have a right to elect to retain their rights to the original asset or to claim the proceeds which should have been realised on the sale of the original asset pursuant to the clients' instructions. Instead, the Administrators have deemed clients to have elected to retain their increased CME (or any asset purchased with that increased CME). I am satisfied that the complexity of what is required is such that it is in practice impossible to give the clients a right to elect and impossible to put clients in a position where they could make an informed choice.

39. Mr Weaver's conclusions were that although there were winners and losers, to the extent that the provisions of the Distribution Plan interfered with the strict legal rights of beneficiaries it did so (a) in a rational and sensible way; (b) by taking the available path of least interference or least prejudice possible; (c) by avoiding alternative approaches with a greater risk of prejudice; (d) by avoiding the incurring of significant levels of costs which would be borne by all beneficiaries to their obvious detriment; and (e) by promoting Objective 1 and the requirement for speed therein.

40. Having considered all the material carefully, I am satisfied that it is fair and reasonable for the Distribution Plan to be based on the reconciliation exercise, notwithstanding the fact that it involves some departure from the strict rights of some of the clients. The Distribution Plan is as fair an approximation of each client's interest in the Client Assets as can be practically achieved if there is to be a speedy return of assets. I am satisfied that approving this Distribution Plan based on the reconciliation exercise is in the interests of all clients, including those who may in fact receive less than their strict entitlement.

Costs Reserve – general observations

41. The Distribution Plan provides for a costs reserve of £18.4m to be retained by the Administrators. This amounts to £6.5m of incurred costs (as at 5 April 2024) and estimated future costs of £11.9m. This is said to represent "*a prudent amount*" such that "*there is no real prospect of the costs ultimately exceeding the reserve*".

42. The costs are to be borne per capita and (if the Potential Litigation Reserve is approved) result in each client bearing a £23000 share of the costs or the value of their Client Assets if lower. One of the consequences of a calculation in this way, is that because of the profile of the portfolios of the FSCS protected clients, this will result in the maximum FSCS compensation being available to meet the costs of the Distribution Plan when compared with, say, a pro rata calculation. If one considers the interests of clients as a whole, that is in their interests. It is possible that there will be losers as well as winners – but there should be very few losers, and many more winners if costs are

calculated in this way. I am satisfied that that is a fair system, particularly in circumstances where it will ensure that the maximum FSCS compensation is available.

43. Provision is made in clauses 13.2 and 14.2 of the Distribution Plan for the Administrators to calculate whether the costs reserve should be reduced at 3-month intervals. In the event the costs reserve is reduced, provision is made in clause 14 of the Distribution Plan for the Administrators to pay a rebate to the relevant clients or the FSCS (as appropriate).

44. I have not been provided with any material to form a view whether the size of the estimated reserve (excluding the Potential Litigation Reserve) and the amounts incurred or to be incurred in returning Client Assets, are reasonable or not. For clients who will not be made whole again by FSCS compensation there is a financial interest in the costs being as low as possible. They may not have the wherewithal to interrogate or challenge any proposed expenditure under the mechanisms provided by rules 201 (Creditors' and clients' requests for further information) and 202 (Claim that remuneration is excessive) of the IBSA Rules. Nevertheless, in respect of the majority of cases which are under the £85000 FSCS cap, there is a clear financial interest on the part of the FSCS in the costs being minimised so as to reduce its overall burden of compensation. I have a witness statement from Mr Guy Thomas Enright, a Recoveries Finance Manager for the FSCS and its representative on the Committee, stating that the FSCS regards it as in its interests, and part of its role on the Committee to monitor the costs being incurred. A reduction in the costs will free up the resources allocated by the FSCS to WealthTek to be used elsewhere. I take comfort from this assurance on behalf of the FSCS and accept that the FSCS is a suitable body to monitor the costs incurred by the Administrators in this case.

Costs Reserve – the Potential Litigation Reserve

45. Approximately 40% of the costs reserve the Administrators propose to maintain relates to potential litigation they are considering ("**the Potential Litigation**"). This amounts to £7,168,218. The Administrators have not yet determined whether they will pursue the Potential Litigation and, if so, what form or forms it will take. The Administrators are undertaking enquiries and investigations but say that for reasons of confidentiality and to avoid prejudicing any actions that the Administrators may identify against any

third parties, they are unwilling to provide any further information to the Court in relation to those enquiries and investigations.

46. The Committee has been briefed on the costs reserve which the Administrators intend to keep and has confirmed its support for the proposed approach.

47. Clients with lower value claims will be unaffected by the creation of the Potential Litigation Reserve. They will be fully compensated for their shortfall and costs contributions even with the inclusion of the Potential Litigation Reserve. Removing that reserve, therefore, will have no impact on the compensation they receive and would instead reduce the amount the FSCS is required to pay out. The FSCS is a member of the Committee and is clearly content that the Potential Litigation Reserve forms part of the overall costs reserve.

48. However, some 21% of clients have shortfalls so large that they will not be compensated in full if the Potential Litigation Reserve is created; and these clients will see the amount they receive (by the return of Client Assets and FSCS compensation) increase by up to £9,500 per client if the Potential Litigation Reserve is not created. These clients have not been consulted on or asked to agree to the Potential Litigation Reserve.

49. The Administrators contend that the Potential Litigation Reserve is necessary to achieve Objective 1. "Client Assets" they submit include not just assets under their control, but also assets which should have been held by the investment bank at the date of administration. I think the right analysis is that in the situation that there are missing assets from a client's account there will likely be a claim against third parties which is a chose in action and is itself an asset. If it vests in the trustee in that capacity it is held for the benefit of the relevant client. The chose in action represents (and is equivalent to) the missing assets which the institution had undertaken to hold for the client and is therefore itself a client asset for the purposes of Objective 1; see Regulation 10B(13). Objective 1 requires the Administrators to return that chose in action to the client "as soon as is reasonably practicable". The starting point must be that the return of the chose in action "as soon as is reasonably practicable" is to take the steps necessary to empower the client to bring a claim in the client's own name against the third parties. This may not require any action by the Administrators - in a bare trust the beneficial

owner of the trust fund will have a concurrent right with the trustee to bring certain types of claim in relation to the trust property, joining the trustee as defendant if necessary to make good the beneficiary's title. Each beneficiary can choose whether to commit further monies in the hope of obtaining a recovery. Those who do can, if they wish, act together to bring a group claim, perhaps with the benefit of litigation funding and ATE insurance.

50. That said, in appropriate circumstances, a fair and reasonable plan for the return of client assets could include a plan for the chose in action to be converted into money or assets by the pursuit of proceedings by the administrator, or by the trustee which is controlled by the administrator. This may be because for practical, procedural or legal reasons if a claim is to be brought, it has to be brought by the administrator or trustee.

51. The first difficulty I have is that the Administrators have proposed a Potential Litigation Reserve but provided the Court with no information about what claims might be brought and against whom and as if it is their entitlement to bring proceedings for the benefit of some clients at the expense of all clients. Without information as to what claims are being contemplated it is impossible to assess whether the Potential Litigation comprise of claims which must be brought by the Administrators rather than by the clients. A bare trust is one in which the trustee holds the trust fund for a beneficiary absolutely. The beneficiary is the beneficial owner of the trust fund and has the right to wind up the trust and call for the transfer of the trust fund to the beneficiary. The trustee has no discretion as to whether to retain or return the trust fund if it is demanded - it is the trustee's duty to return the trust fund. As a matter of trust law, the trustee of a bare trust is simply not entitled to arrogate the right to bring proceedings to himself against the wishes of the beneficiary, or to refuse to distribute the trust fund to the beneficiary because the trustee wishes to bring such proceedings against the wishes of the beneficiary. Imposing a retention in the Distribution Plan of over £7 million for the Potential Litigation, as the Administrators propose, overrides the clients' rights to terminate the bare trust in respect of their money and to require its return. The overriding of clients' rights is even more egregious if it is proposed that there should be a retention of a client's funds or compensation for Potential Litigation from which that client will not benefit. As discussed above in relation to the reconciliation exercise, I accept that there is jurisdiction to authorise a Distribution

Plan which does not give effect to the strict rights of the clients, but it is subject to the safeguard of requiring the Court's approval. That approval will not be given unless the court is satisfied that what is proposed is fair and reasonable.

52. There has been no consultation with the clients beyond the Committee on the Potential Litigation and the Potential Litigation Reserve. The Committee comprises 4 clients (out of 1320) and the FSCS. I have not been told whether any of the 4 clients on the Committee are in the 21% who will receive a smaller distribution and compensation package if the Potential Litigation Reserve is made, but it would make little difference if one or more were. Each client will have their own view depending on their circumstances as to whether or not they wish litigation against third parties to be explored by the Administrators for their benefit and their funds reserved for the costs of that exercise. It may take years to prosecute the Potential Litigation and obtain a recovery. Some of the 21% of clients who have not been made whole may not wish to have their funds retained for that purpose and may prefer to forego any right of recovery for a greater distribution now. Some of these clients may be more concerned about their present financial position and their age and may not wish to wager some of the financial pot for a future return when they need money now, or where the future return might not be received while they are still alive. I have been given no explanation as to why it is fair and reasonable to impose on these clients a retention of their clients' funds against their wishes.

53. In the absence of information as to the Potential Litigation, it is not possible to say that there is some compelling legal or procedural reason why the litigation should be brought by the Administrators rather than by the clients as a class. Even if that were so, I doubt that it would be fair and reasonable to force any individual client who would rather have an enhanced compensation and distribution package now, and to forego the prospect of future recovery against a third party, to nevertheless "pay" a share of the Potential Litigation costs. These are separate trusts for each client. There are some decisions which have to be made on behalf of all clients, such as whether costs should be apportioned *pro rata* or *per capita* or whether the reconciliation exercise should be approved. There are winners and losers on those issues and a fair way of approaching those issues is to have regard to whether the unfairness to the losers can be justified by having regard to what is best for the clients as a whole. However, a decision whether

there should be a Potential Litigation Reserve does not appear (at least on the sparse information I have) to be a decision which must be made on behalf of all clients. I do not presently see why those of the affected 21% of clients who did not wish to participate could not simply be excised from the arrangement. I do not see that this is an issue on which the interests of the minority may have to give way to the interests of the class as a whole. That is also a reason why the views of the Committee that the Potential Litigation Reserve is in the interests of clients generally does not carry much weight with me.

54. I am therefore not satisfied that the proposals for the retention of the Potential Litigation Reserve have been informed by the right principles. In its current form, whereby the Potential Litigation Reserve would be held indefinitely by the Administrators, with no timetable for reporting to clients or the Court on the Potential Litigation or obtaining the periodic consent of the 21% who are financially affected by the Potential Litigation Reserve to the continued retention of their funds or compensation, the proposals seems to me to be positively contrary to Objective 1. I am not satisfied that the Distribution Plan would be fair and reasonable if it included the Potential Litigation Reserve. I will not approve that element of the Plan in its current form.