Neutral Citation Number: [2010] EWCA Civ 561

Case Nos: 2009/1673, 1676, 1679, 1686 and 1687

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT
MR JUSTICE PETER SMITH
[2009] EWHC 1633 (Ch)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 27 May 2010

Before:

LORD JUSTICE SEDLEY
LORD JUSTICE THOMAS
and
LORD JUSTICE LLOYD

- -

IN THE MATTER OF KAUPTHING SINGER & FRIEDLANDER LIMITED
(in administration)

Between:

(1) PATRICK BRAZZILL	**Applicants**
(2) ALAN BLOOM	
(3) THOMAS BURTON	**Respondents**
(4) MARGARET MILLS	**to all appeals**
(administrators of Kaupthing Singer & Friedlander Ltd)	
- and -	
	Appellants:
(1) BERNADETTE WILLOUGHBY	**appeal 1673**
(representative of the Singer & Friedlander Ltd Pension and Assurance Scheme)	
(2) KAUPTHING SINGER & FRIEDLANDER (ISLE OF MAN) LTD	**appeal 1679**
(3) TRANSPORT FOR LONDON	**appeal 1676**
(4) HM TREASURY	**appeal 1686**
(5) FINANCIAL SERVICES COMPENSATION SCHEME	**appeal 1687**

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Richard Snowden Q.C. and Ben Shaw (instructed by **Freshfields Bruckhaus Deringer LLP**) for **the Administrators**

Stuart Isaacs Q.C. and Marcus Haywood (instructed by **Pinsent Masons LLP**)
for **Bernadette Willoughby**
Lloyd Tamlyn (instructed by **Nabarro LLP**) for
Kaupthing Singer & Friedlander (Isle of Man) Ltd
Richard Gillis Q.C. and Sam O'Leary (instructed by **Herbert Smith LLP**)
for **Transport for London**
Robin Dicker Q.C. and Andreas Gledhill
(instructed by **Slaughter and May**) for **HM Treasury** and
(instructed by **Denton Wilde Sapte LLP**) for the **Financial Services Compensation Scheme**

Hearing dates: 23 and 24 March 2010

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Approved Judgment

Lord Justice Lloyd:

Introduction

1. The collapse of the Icelandic bank Kaupthing hf (Kaupthing) in October 2008, and the consequences for its UK-based indirect wholly-owned subsidiary Kaupthing Singer & Friedlander Ltd (KSF), have kept lawyers busy. Already this court has considered an appeal from a decision of Norris J on a question of set-off: [2010] EWCA Civ 518, the Chancellor has had to rule on issues concerning the rule in *Cherry v Boultbee*: [2009] EWHC 3377 (Ch), and an appeal from that decision is on its way directly to the Supreme Court of the United Kingdom. Now we have to decide five appeals from an order of Peter Smith J, following a judgment given on 10 July 2009: [2009] EWHC 1633 (Ch).

2. KSF was an authorised institution under the Financial Services and Markets Act 2000 (FSMA). Pursuant to that authorisation by the Financial Services Authority (FSA), it carried on business in England including the taking of deposits. KSF had a variety of customers holding different types of account, including members of the general public, corporations (including members of the Kaupthing group) and local authorities. Among these different accounts KSF offered savings accounts operated only online called Edge Accounts; these were available either as a savings account or as a fixed term deposit account. The interest rates offered on Edge Accounts were high compared to similar products offered by other financial institutions.

3. Following the collapse of Lehman Brothers in September 2008 and the general disruption in global credit markets at that time, compounded by difficulties facing the Icelandic economy and banking system in general and Kaupthing in particular, KSF faced extremely difficult trading conditions, a sudden deterioration in its liquidity situation and a general loss in public confidence at the beginning of October 2008.

4. In those circumstances the FSA took steps under its regulatory powers under FSMA, in particular by issuing a First Supervisory Notice (the Notice) to KSF on 3 October 2008. By the Notice KSF was required to open a segregated trust account on terms specified in the Notice, to credit the account with a cash amount at least as great as the aggregate value of deposits accepted by KSF from its customers during 2 and 3 October, and thereafter to credit it with a cash amount at least as great as the value of subsequent deposits accepted by KSF from its customers from time to time. In accordance with the Notice KSF opened an account (the Account) with the Bank of England (the Bank) and paid certain amounts into the Account on 6 and 7 October 2008. The issues in the present proceedings concern the claims to beneficial entitlement to the money in the Account on the part of various competing interests.

5. Payments into the Account did not continue beyond 7 October because on 8 October, on the one hand, KSF went into administration, on the application of the FSA and, on the other hand, shortly before the administration order was made, the Treasury (HMT) exercised powers under the Banking (Special Provisions) Act 2008 (the 2008 Act) to make an Order (the Order) by which, in effect, all Edge Accounts were transferred, indirectly, to ING Direct NV (ING). In this way, all holders of Edge Accounts became entitled to exactly similar accounts with a reliable institution. Value was given for the assumption of liability by ING for these liabilities by HMT and by the Financial Services Compensation Scheme (FSCS, or sometimes "the Scheme") in a

way which I will describe, and which itself gives rise to questions raised in these proceedings.

The proceedings and the parties

6. The proceedings themselves were commenced by the administrators of KSF, to obtain the court's assistance as regards the entitlement to the money in the Account. Several parties were identified to represent the interests of a number of relevant classes of claimant. Not all classes are still relevant, and I will not mention those who are not.

   i) The first appellant, Bernadette Willoughby, who is (and is a party as) a trustee of the Singer & Friedlander Ltd Pension and Assurance Scheme, represents:

      a) KSF account holders in respect of whom money was transferred to the Account corresponding to their deposits during the relevant period (2-8 October), whose accounts were not transferred to ING and who are not entitled to claim compensation under FSCS;

      b) KSF account holders in respect of whom money was transferred to the Account corresponding to their deposits during the relevant period, whose accounts were not transferred to ING and who are entitled to claim compensation under FSCS (whether or not they have done so);

      c) KSF account holders in respect of whom money was transferred to the Account corresponding to their deposit in the relevant period but whose accounts (arguably) should not have been treated as customer accounts or whose deposits (arguably) should not have been treated as deposits.

      It is in the interests of these classes to argue that a valid trust was created over the money in the Account, but only for the benefit of those customers in respect of whose accounts with KSF money was paid into the Account. The issue as to deposits and customers arises because the Notice did not define either customer or deposit. Some contend that deposit has the same meaning as it bears for the purposes of FSMA, which was then set out in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (the RAO); I will refer to this as the regulatory meaning. Others contend that it has a wider meaning.

   ii) Transport for London (TFL) represents trade creditors of KSF and any account holders who did not make deposits during the relevant period and in respect of whose accounts KSF made no payment into the Account. This class has no possible claim to money in the Account as such and their interest is in maximising any recovery of KSF from the Account.

   iii) A sister company of KSF, Kaupthing Singer & Friedlander (Isle of Man) Ltd (KSFIOM), represents KSF account holders in respect of whom, on the true construction of the Notice, KSF ought to have transferred money into the Account but it did not do so. The interest of this class is to argue that a valid trust was created over the money in the Account and that the beneficiaries of that trust are the account holders in respect of whom money ought to have been transferred to the Account, whether or not it was and whether or not the

amount transferred was correct. This class included those who made deposits in foreign currencies. At trial, the sub-category of creditors which included foreign currency depositors was separately represented from KSFIOM itself. That was not perceived as necessary on the appeal, although, as I will mention later, a point did arise for decision concerning the foreign currency deposits.

iv) HMT and FSCS were joined as parties because of their having provided funding for the transfer of Edge Accounts to ING under the Order and because of their claim that, by virtue of the terms of the Order, or of their having provided such funding in any event, they are entitled to corresponding sums to the exclusion of KSF.

7. The proceedings came on for trial before Peter Smith J in May 2009. In his reserved judgment, he held (a) that a valid trust had been created over the money in the Account, (b) that the beneficiaries were not limited to those in respect of whose accounts money had been transferred into the Account, but extended to all those who had made payments during the relevant period such that, on the correct construction of the Notice, KSF should have made payments into the Account, and (c) that the correct interpretation of the Notice was that "deposit" meant a sum of money paid on terms that it would be repayable, and that it was not limited to the regulatory meaning. He also held (d) that deposits in foreign currency were included within the obligation to make transfers under the Notice. The latter point is not challenged on appeal, though a point affecting the interests of the foreign currency creditors did arise before us. The basic proposition that the money in the Account was held on trust is also not challenged. All the other points that I have mentioned are in issue. He also held that, by virtue of the Order, (e) the rights of deposit holders whose deposits were transferred to ING were assigned to FSCS, but that (f), if this had not been the case, neither FSCS nor HMT would have had a claim by way of subrogation. Those two issues are alive on the appeals.

8. We had the benefit of clear and helpful written and oral submissions from all Counsel, who had, moreover, collaborated sensibly as to the division of responsibilities between them in order to avoid repetition, and to enable the argument to be concluded in two days. Mr Snowden Q.C. for the administrators, while neutral on the issues raised in the Appellant's Notices, provided a useful introduction to the issues in his skeleton argument, with a guide to the documents which it was most sensible for the court to read in advance.

9. Thus, issues arise both on the Notice, and what was done under it, and on the Order. I will start with the first group of issues. For this purpose I must set out details of the facts concerning the Notice and the opening of the Account.

The Notice, and the opening and operation of the Account

10. The Notice, issued by the FSA and headed "First Supervisory Notice", was addressed to KSF, and gave notice that, under sections 43, 45 and 48 of FSMA, the FSA had decided to impose requirements on KSF set out in the Notice. These newly imposed requirements, which took effect immediately, operated as a variation of the terms on which KSF was authorised under FSMA. Peter Smith J helpfully set out the whole of the Notice, and the whole of the Order, as appendices to his judgment, so that the entire text is available to be seen. I will only set out those passages that are most

directly relevant. Paragraph (2) of the Notice, under the heading "Action", is central to the first group of issues on the appeals. It is as follows:

> "The Firm is required to:
>
> (a) immediately open a segregated trust account (the 'account') with the Bank of England, or another account provider in the United Kingdom which has been approved in writing and for this purpose by the FSA, on the terms set out in (d) and (e) below;
>
> (b) upon opening the account, credit it with a cash amount which is at least as great as the aggregate value of the deposits accepted by the Firm from its customers during the course of 2 and 3 October 2008 (the 'initial deposits');
>
> (c) thereafter credit the account with a cash amount which is at least as great as the value of any subsequent deposits accepted by the Firm from its customers from time to time (the 'subsequent deposits');
>
> (d) hold money standing to the credit of the account on trust for the benefit of the customers referred to in (b) and (c) above according to their respective interests in it (which shall be the amount of their deposit(s) less any sum withdrawn on their account); and
>
> (e) apply the money standing to the credit of the account solely to repay the initial deposits and the subsequent deposits to those customers."

11. Paragraph (3) required KSF to maintain at all times a given minimum amount (including the sum in the Account). Paragraph (4) imposed a requirement of the FSA's consent for any payment to any person, or a person and his associates, in excess of £250,000, and likewise to any such disposition of assets, other than in favour of KSF's parent company or any member of the group. Dispositions in favour of the parent or group companies were subject to another constraint in paragraph (5) and (6)(a), namely the need for at least 3 days' written notice, and confirmation by the FSA that it had no objection. KSF was required to refrain from any further marketing of its products in the UK, was required to draw down on any open credit lines it had in order to establish and maintain a liquidity position as described in KSF's liquidity mismatch guidance, and was also required to call in any debts due to it from its parent company. By paragraph (7) "group" and "associate", as used in the Notice, were to have the meanings in particular provisions of FSMA.

12. The Notice also gave the FSA's reasons for deciding to issue it. It stated that the FSA had concluded, on the basis of facts and matters stated in the Notice, that KSF was failing, or was likely to fail, to satisfy Threshold Condition 4 (adequate resources) in Part 1 of Schedule 5 to FSMA, and/or that it was desirable to exercise the variation of permission in order to protect the interests of consumers or potential consumers. The Notice referred at paragraph (10) to the FSA's regulatory objectives as including "the protection of consumers and maintaining confidence in the financial system operating in the United Kingdom". At paragraph (11) it referred to the FSA's ability under section 45(1) to exercise its powers in relation to an authorised person in certain

circumstances, and, under section 45(4) to include any provision in the varied permission that could be included if a fresh permission were being given. Paragraph (12) was as follows:

> "By section 43(1) of the Act, a Part IV permission may include such requirements as the FSA considers appropriate, by section 43(2)(b) a requirement may be imposed to require a firm to refrain from taking specified action. By section 48 of the Act, on giving a person a Part IV permission, the FSA may impose an assets requirement on that person (and so, by virtue of section 45(4) of the Act, the FSA may impose such requirements when varying an authorised person's Part IV permission)."

13. The Notice summarised at paragraph (26) the FSA's conclusions which led it to impose the requirements, as follows:

> "The facts and matters described above lead the FSA, having regard to its regulatory objectives to the following conclusions:
>
> (a) There is a material risk that the general economic conditions affecting the Firm and/or its Parent, and the downgrading of the Firm's credit rating, pose a risk to the ongoing viability of the Firm and/or its Parent's or its Parent's group's business model.
>
> (b) There is a material risk that the Firm's assets will be inappropriately transferred or dissipated to the significant detriment of consumers (including the Firm's depositors).
>
> (c) Acute adverse market conditions mean that the Firm is experiencing, or is likely to experience, material liquidity difficulties and there is a material risk that its liquidity position will deteriorate rapidly and to such an extent that it will be unable to pay its liabilities as they fall due.
>
> (d) If this occurs, the Firm will be in breach of GENPRU 1.2.26R, which requires a firm at all times to maintain overall financial resources, including capital resources and liquidity resources, which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due."

14. The Notice then explained why the requirements were imposed with immediate effect, which included the fact that KSF was continuing to accept new deposits. It also prohibited publication of the Notice or any details concerning it, for the reasons set out in paragraph (29):

> "In the opinion of the FSA, publication of any information about the matter to which this notice relates would be prejudicial to the interests of consumers, since it would be likely to provoke a crisis of confidence in the Firm which would make it more difficult to protect the interests of existing depositors."

15. The judge noted that no evidence was given by anyone who had been involved within KSF in dealing with compliance with the notice, or in particular with setting up the Account. However, the evidence of Margaret Mills, one of the administrators, explained what had happened, on the basis of information derived from sources within KSF, in particular Ian Carrigan, Manager of Operations at KSF, who had responsibility for the transfers to the Account, and she exhibited the sequence of emails which related to the setting up of the Account.

16. Having received the Notice, staff at KSF developed an IT script designed to select all transactions from customers which had the word "customer" in the account description or account type field. The transactions listed as a result of the application of this script were then adjusted manually to exclude transactions which KSF considered to be outside the scope of the Notice, including money market deposits, KSF investment management operations, and transactions with group companies and with banks and financial institutions. This process did not exclude foreign currency deposits as such, but in fact no payments were made into the Account in respect of such deposits as such, as the Account was in sterling, and the calculations were not made that would have been necessary to work out the sterling equivalent of these deposits.

17. The process of setting up the Account was the responsibility, within KSF, of Jim Youngs, the company secretary. The Account was opened shortly before 6 am on Monday 6 October. Its terms are recorded in a letter from the Bank dated 5 October, countersigned on behalf of KSF. Only one of the terms requires mention. This was a statement as follows:

> "(iv) the account and monies in the account must be operated in accordance with any requirements imposed by Financial Services and Markets Act 2000 (*FSMA*) or by the Financial Services Authority (the *FSA*) under FSMA and, in particular, the requirements imposed on KSF by the FSA in its First Supervisory Notice dated 3 October 2008 (the *Notice*). Monies in the account must not be used or transferred contrary to any such requirement. The Bank of England will not act on any instructions from KSF in relation to payments which the Bank of England believes require confirmation by the FSA that it has no objection unless the Bank of England is satisfied, in its absolute discretion, that the FSA has given such confirmation. The Bank of England shall have no liability whatsoever for declining to act on any instructions which it believes to be in contravention of the Notice or for the delay in making any payment as a result of seeking confirmation that the FSA has confirmed that it has no objection to any payment."

18. In the course of the email exchange, KSF had stated to the Bank, which had acknowledged it in terms, that all money deposited in the Account was to be held on trust for the customers of KSF in accordance with the terms of the Notice.

19. KSF made a payment to the credit of the Account early on 6 October in respect of the sums received by it in the terms of the Notice on 2 and 3 October. At or about the end of the day on 6 and 7 October KSF made further payments in respect of the deposits received on each of those days. In respect of each of the three payments, Mr Carrigan

worked from data provided to him by the staff of KSF, which he checked in order to decide which transactions were to be excluded manually in the process of working out the aggregate amount of the "customer deposits" for the relevant period. According to the evidence there were some instances where he was not sure, at the time when he made the calculation, whether a particular payment was or was not a customer deposit. In those cases "he erred on the side of inclusion": see the witness statement of Bonnie Mendelsohn made on 11 May 2009, paragraph 5(2)(a). An example was £3 million paid by a county council on 2 October which was included but which he later concluded ought not to have been included.

20. KSF did receive deposits for the credit of accounts in currencies other than sterling (US dollars, Euros, Japanese Yen, Swedish Kroner, Canadian dollars and Singaporean dollars) during the relevant period, some of which, at least, would have qualified as customer deposits on any basis. The practicalities of dealing with these in accordance with the Notice meant that it would have been significantly more time-consuming than for sterling deposits, at a time when the relevant staff were under intense time pressure already. It was appreciated that it would be likely to be necessary for a payment to be made into the Account (or an equivalent foreign currency account or accounts) in respect of at least some of the foreign currency deposits. According to the evidence it was envisaged that the necessary calculation for this purpose was likely to be carried out in due course, and no later than 24 October, and an appropriate payment would then have been made. It did not happen because of the intervening events on 8 October.

21. On 8 October no further credits were made to the Account. Any deposits made to KSF accounts during that day were returned to the depositor. A withdrawal of £1,164,356.38 was made from the Account on that day because the payment on 7 October had included an overpayment in that amount. The Bank agreed to that withdrawal being made.

22. The amount transferred into the Account (net of the withdrawal just mentioned) was £147,436,226.05. That, with accrued interest, is the fund in dispute on the appeals. Of this total, £126,609,271.94 was transferred in respect of Edge Accounts, which accounts were then transferred to ING. £8,875,172.55 paid into the Account represented deposits by a local authority (£3 million) and group companies. On the other hand, financial institutions and group companies made deposits amounting to £141,024,637.43 in the relevant period in respect of which no payment was made into the Account. Foreign currency deposits within the scope of the regulatory meaning of deposit amounted to £6,282,662.69; these should have been, but were not, taken into account in the calculation of what was to be paid into the Account. Also, during the relevant period, there were withdrawals from accounts with KSF amounting to approximately £22,622,439 which had been the subject of matched payments into the Account.

The legislation

23. By virtue of section 19 of FSMA (so far as relevant) only an authorised person may carry out a regulated activity. An authorised person means a person who has the FSA's permission to carry out such an activity. Regulated activities are specified in orders made by HMT. The relevant order is the RAO, which specifies, among other things, accepting deposits, if the deposit is to be used by the deposit-taker in either of

two specified ways. The most significant aspect of the definition for present purposes is what deposits are excluded. Those exclusions extend to:

i) Deposits by Governmental and quasi-governmental counterparties: article 6(1)(a);

ii) Deposits by persons connected with the relevant authorised person: article 6(1)(c) and (d);

iii) Deposits by banking counterparties: article 6(1)(b).

24. Taking deposits which are within the regulatory meaning is a regulated activity, whereas taking deposits which are outside that meaning is not a regulated activity.

25. The position as regards permission to carry out regulated activities is governed by Part IV of FSMA. Section 40 provides for relevant persons to apply to the FSA for permission. The FSA may give (or refuse) permission under section 42, and under section 43 it may impose such requirements as it considers appropriate. Section 43 is as follows:

> "(1) A Part IV permission may include such requirements as the Authority considers appropriate.
>
> (2) A requirement may, in particular, be imposed
>
> (a) so as to require the person concerned to take specified action; or
>
> (b) so as to require him to refrain from taking specified action.
>
> (3) A requirement may extend to activities which are not regulated activities.
>
> (4) A requirement may be imposed by reference to the person's relationship with
>
> (a) his group; or
>
> (b) other members of his group.
>
> (5) A requirement expires at the end of such period as the Authority may specify in the permission.
>
> (6) But subsection (5) does not affect the Authority's powers under section 44 or 45."

26. Section 44 deals with the variation of permissions on the application of the authorised person. Section 45 allows the FSA to vary a permission of its own initiative. The section is as follows (ignoring an amendment taking effect after the relevant time):

"(1) The Authority may exercise its power under this section in relation to an authorised person if it appears to it that—

(a) he is failing, or is likely to fail, to satisfy the threshold conditions;

(b) he has failed, during a period of at least 12 months, to carry on a regulated activity for which he has a Part IV permission; or

(c) it is desirable to exercise that power in order to protect the interests of consumers or potential consumers.

(2) The Authority's power under this section is the power to vary a Part IV permission in any of the ways mentioned in section 44(1) or to cancel it.

(2A) Without prejudice to the generality of subsections (1) and (2), the Authority may, in relation to an authorised person who is an investment firm, exercise its power under this section to cancel the Part IV permission of the firm if it appears to it that—

(a) the firm has failed, during a period of at least six months, to carry on a regulated activity which is an investment service or activity for which it has a Part IV permission;

(b) the firm obtained the Part IV permission by making a false statement or by other irregular means;

(c) the firm no longer satisfies the requirements for authorisation pursuant to Chapter I of Title II of the markets in financial instruments directive, or pursuant to or contained in any Community legislation made under that Chapter, in relation to a regulated activity which is an investment service or activity for which it has a Part IV permission; or

(d) the firm has seriously and systematically infringed the operating conditions pursuant to Chapter II of Title II of the markets in financial instruments directive, or pursuant to or contained in any Community legislation made under that Chapter, in relation to a regulated activity which is an investment service or activity for which it has a Part IV permission.

(2B) For the purposes of subsection (2A) a regulated activity is an investment service or activity if it falls within the definition of "investment services and activities" in section 417(1).

(3) If, as a result of a variation of a Part IV permission under this section, there are no longer any regulated activities for which the authorised person concerned has permission, the Authority must, once

it is satisfied that it is no longer necessary to keep the permission in force, cancel it.

(4) The Authority's power to vary a Part IV permission under this section extends to including any provision in the permission as varied that could be included if a fresh permission were being given in response to an application under section 40.

(5) The Authority's power under this section is referred to in this Part as its own-initiative power."

27. Another provision referred to in the Notice was section 48, which allows the FSA to impose an assets requirement on a person when giving permission under Part IV. It is as follows:

"(1) This section applies if the Authority

(a) on giving a person a Part IV permission, imposes an assets requirement on him; or

(b) varies an authorised person's Part IV permission so as to alter an assets requirement imposed on him or impose such a requirement on him.

(2) A person on whom an assets requirement is imposed is referred to in this section as "A".

(3) "Assets requirement" means a requirement under section 43

(a) prohibiting the disposal of, or other dealing with, any of A's assets (whether in the United Kingdom or elsewhere) or restricting such disposals or dealings; or

(b) that all or any of A's assets, or all or any assets belonging to consumers but held by A or to his order, must be transferred to and held by a trustee approved by the Authority.

(4) If the Authority

(a) imposes a requirement of the kind mentioned in subsection (3)(a), and

(b) gives notice of the requirement to any institution with whom A keeps an account,

the notice has the effects mentioned in subsection (5).

(5) Those effects are that

(a) the institution does not act in breach of any contract with A if, having been instructed by A (or on his behalf) to transfer any sum or otherwise make any payment out of A's account, it

> refuses to do so in the reasonably held belief that complying with the instruction would be incompatible with the requirement; and
>
> (b) if the institution complies with such an instruction, it is liable to pay to the Authority an amount equal to the amount transferred from, or otherwise paid out of, A's account in contravention of the requirement.
>
> (6) If the Authority imposes a requirement of the kind mentioned in subsection (3)(b), no assets held by a person as trustee in accordance with the requirement may, while the requirement is in force, be released or dealt with except with the consent of the Authority.
>
> (7) If, while a requirement of the kind mentioned in subsection (3)(b) is in force, A creates a charge over any assets of his held in accordance with the requirement, the charge is (to the extent that it confers security over the assets) void against the liquidator and any of A's creditors.
>
> (8) Assets held by a person as trustee ("T") are to be taken to be held by T in accordance with a requirement mentioned in subsection (3)(b) only if
>
> (a) A has given T written notice that those assets are to be held by T in accordance with the requirement; or
>
> (b) they are assets into which assets to which paragraph (a) applies have been transposed by T on the instructions of A.
>
> (9) A person who contravenes subsection (6) is guilty of an offence and liable on summary conviction to a fine not exceeding level 5 on the standard scale.
>
> (10) "Charge" includes a mortgage (or in Scotland a security over property).
>
> (11) Subsections (6) and (8) do not affect any equitable interest or remedy in favour of a person who is a beneficiary of a trust as a result of a requirement of the kind mentioned in subsection (3)(b)."

28. The Threshold Condition as regards adequate resources is set out in Part 1 of Schedule 6 to FSMA, and is determined by reference to the authorised person's regulated activities. Correspondingly, in relation to the protection of consumers, which is one of the FSA's regulatory objectives, a consumer means someone who uses, has used or is contemplating using, services provided by an authorised person carrying on regulated activities: FSMA section 5(3) and section 138(7).

The issues

29. Two separate issues need to be decided about who are (or were) the beneficiaries of the money in the Account. One is whether they are only those accountholders of KSF

in respect of whose accounts payments were in fact made into the Account; if that were correct the Account would be analogous to a solicitor's client account, in that a trust would be created only as regards the sums paid into the Account, as and when they were so paid. The alternative on this point, upheld by the judge, is that the money in the Account was held on trust for all accountholders of KSF in respect of whose deposits payments should have been made into the Account in accordance with the Notice. For that to be right the trust would have been declared when the Account was set up, by reference to the requirements of the Notice.

30. If the latter is the correct position, the next question is whether deposits referred to in the Notice were only those which fall within the regulatory meaning, or whether the word should be construed more widely, as the judge held. According to which is correct, the class of beneficiaries is wider or less wide, and in the latter case the shortfall will be the less and there might be no shortfall, depending on the answer to the next question.

31. That question, the third, concerns the right of KSF to make withdrawals from the Account. No withdrawals were in fact made (except for one on 8 October in respect of a mistake which had been identified as regards a payment into the Account on the previous day), but it is argued that KSF could, consistently with the terms of the Notice, have made such withdrawals and the fact that it did not at the time does not prejudice its rights in that respect. The main argument on this point is as to whether KSF was entitled to make withdrawals, as regards payments made to accountholders who had themselves made withdrawals from their accounts with KSF, if KSF had not paid into the Account everything that it ought to have done in accordance with the Notice. The judge held that it could. If "deposit" has its regulatory meaning, a similar point arises also as regards payments made into the Account in respect of deposits by customers who were not within the terms of the Notice, so that their deposits did not require to be matched by payments into the Account.

32. In addition to these issues, raised by the various Appellant's Notices, a point of detail arose before us about the rates to be used for the conversion of foreign currency deposits into sterling and of withdrawals against such deposits back into the relevant currency. I will explain that later.

33. The other issues arise from the Order. First of these is whether the judge was right to hold that FSCS was entitled to be regarded as the assignee of the rights of holders of Edge Accounts with KSF whose accounts were transferred to ING. The other, which is an alternative to that, is whether HMT and FSCS were in any event entitled to be subrogated to the rights of such accountholders by reason of their having made payments or assumed liabilities on the occasion of the transfer to ING; the judge held that they would not be.

34. I will deal with these various issues in the order in which I have described them.

Beneficiaries: client account or class trust?

35. The judge held that the beneficiaries of the trust affecting the money in the Account were all members of the class of accountholders of KSF in respect of whom money should have been paid into the Account in accordance with the Notice, whether or not money was so transferred, and their interest extended to the amount that should have

been paid in, whether or not the correct amount was so transferred. The judge's reasoning was bound up with that which he applied to the anterior question (not raised before us) whether there was a trust at all. He regarded KSF (by its relevant officers) as intending to set up the trust which the Notice required it to set up, and as having done so.

36. On behalf of Ms Willoughby, Mr Isaacs Q.C. challenged this conclusion. He argued that the Notice itself had no effect other than to oblige KSF to act in accordance with its terms, and that the question turned not on what KSF ought to have done but on what it actually did. He submitted that KSF's actions showed it making its own decisions as to what transfers should be made in respect of what accounts, which did not necessarily (and as it turned out did not in fact) coincide with KSF's obligations under the Notice. While the Bank was on notice, and accepted, that the Account contained money held on trust, this by itself did not affect the question as to what the trusts were.

37. He cited in support of his arguments the decision of this court in *Moriarty v Atkinson* [2008] EWCA Civ 1604. In that case, money which should have been paid into a client account (and would, once there, have been held on trust for the particular client) was instead paid into the company's general account, which was substantially overdrawn. There was a surplus in the client account over the amounts due to the clients in respect of whom it had been paid in. Clients for whom money had not been but should have been paid in claimed an interest in this surplus. Lord Neuberger of Abbotsbury, Dyson and Jacob LJJ upheld the decision of Nicholas Strauss Q.C. in the Chancery Division that this claim failed, because the money attributable to the particular clients had never formed part of the trust fund.

38. The distinction between that case and this is in the terms of, and the basis on which KSF set up, the Account. I accept that the Notice itself could not create a trust; it obliged KSF to create one, and it prescribed the terms of the trust and (as a minimum) the property which was to be subject to the trust. It was up to KSF to do what was necessary in order to comply. What KSF did was to open the Account with the Bank, and then to make payments into it.

39. The process which led to the opening of the Account started in the afternoon of Sunday 5 October, when the Bank (which had already received a copy of the Notice) sent to KSF its Terms and Conditions for the opening of an account. Later it sent the mandate which had been prepared for the particular purpose. KSF made the point that, in order to comply with the notice, the account had to be acknowledged as being a trust account, and not subject to set-off. The Bank dealt with that by reference to the text which I have quoted at paragraph [17] above, which was to be included in the mandate. The FSA later confirmed that this text was suitable for its purposes. Late that night KSF sent the Bank an email stating that:

> " … in compliance with the Supervisory Notice issued by the Financial Services Authority on 3rd October 2008, this email constitutes notice to the Bank of England that all monies deposited in the Trust Account are to be held on trust for the customers of [KSF] in accordance with the terms of the Supervisory Notice. I should be grateful if you would acknowledge receipt of this email by return by way of acknowledgment of the trust status of the account."

40. The Bank's reply was: "The monies deposited will be held on trust as set out in your email."

41. KSF signed the Bank's mandate form by way of acceptance of the terms, which included the text quoted above at paragraph [17]. It seems to me that, by doing so, and by sending to the Bank the email to which I have referred, stating that the money in the Account was "to be held on trust for the customers of [KSF] in accordance with the terms of the Supervisory Notice", KSF did declare the trusts affecting all money to be transferred into the Account, which were in favour of all persons in respect of whom it was required to make transfers by the terms of the Notice, and to the extent of the transfers so required. I therefore agree with the judge that the trust was for a class of beneficiaries, and it was not analogous to a client account. The fact that the extreme time pressure under which all concerned were working may have resulted in a mismatch between the transfers which KSF ought to have made, in accordance with the Notice, and the transfers that in fact it did make (for example as regards the relatively modest amount of foreign currency deposits) does not seem to me to undermine or subvert the conclusion which I have reached, for the reasons given above. The judge said this at paragraph 137 of his judgment:

> "I should say that whilst my conclusion shows that the full amounts were not paid into the Account by reason of Mr Carrigan's decision I am not intending in any way to express any criticism of him. I have not heard any direct evidence from him and it is impossible in the relatively relaxed atmosphere of the court room even to begin to contemplate the pressures that were put on his team and the attendant pressures that were on the FSA and HMT at the time of these uniquely catastrophic events. Hindsight is a wonderful thing. I have no doubt that all the parties concerned tried their very best to achieve a result that would be for the benefit of KSF's depositors and creditors and thus the reputation of the financial market in the UK at that time."

42. It seems to me that those comments are entirely justified, and that those concerned at KSF were doing all they could to comply with the Notice as best they could in the circumstances.

Beneficiaries: regulated deposits or all deposits?

43. In order to identify the beneficiaries of the Account, it is therefore necessary to decide on the true meaning of the Notice and, in particular, of the words "deposits" and "customers". The contest is between the regulatory meaning of deposit, under the RAO which I have described, and the general meaning, which the judge took as being a sum of money paid on terms that it is repayable. In turn, "customers" means the persons making deposits as so understood.

44. The judge held at paragraph 135 that the Notice was deliberately drafted so that the words "customers" and "deposits" were designed to cover all customers of whatever species who made deposits after the date of the Notice, rather than being restricted to regulated deposits. In his reasoning towards this conclusion, set out at paragraphs 130 to 134, he was influenced both by the failure to define deposits expressly and by what he saw as an anomaly in the differential treatment of regulated and other deposits which would apply if deposit meant only regulated deposits.

45. The judge's conclusion on this point was challenged by Mr Gillis Q.C. for TFL and by Mr Dicker Q.C. for HMT and FSCS, against opposition from Mr Tamlyn for KSFIOM. They argued that the regulatory meaning of deposit is so fundamental to the system of regulation under FSMA that any informed reader of the Notice would naturally take it that the regulatory meaning was intended, unless the opposite was made very clear. They submitted that to construe the Notice as applying to non-regulated deposits was inconsistent with specific aspects of its drafting and would also produce results that cannot be taken to have been intended.

46. As already mentioned, regulation under FSMA extends to the taking of regulated deposits, but not to the taking of non-regulated deposits, even by a firm which is regulated. I would therefore accept that the regulatory meaning of "deposit" is central to this aspect of regulation under FSMA. I also accept that it has an obvious and direct relevance to the Notice as an exercise of the FSA's regulatory powers under FSMA.

47. The Notice is expressed to be given under sections 43, 45 and 48 of FSMA. The reasons for giving it, under section 45, are said to be KSF's failure, or likely failure, to satisfy the threshold condition as to adequate resources, and the objective of protecting the interests of consumers and potential consumers. The terms of FSMA, already noted at paragraph [28] above, show that both of these refer to the firm's regulated activities, and in particular that consumers are those who use the firm's regulated activities. They therefore do not include those who have placed, or may place, deposits with KSF that are outside the regulatory definition. This is itself a pointer towards the Notice being for the protection of those making regulated deposits but not of those outside the regulatory definition.

48. Under section 43, requirements may be imposed on the grant of permission, whether original or varied. It is true that section 43(3) says that a requirement may extend to activities other than regulated activities. On the judge's reading, the Notice did use that power, by controlling KSF's activities in respect of non-regulated deposits. However, paragraph (12) of the Notice refers to section 43(2)(b) (a requirement that KSF refrain from taking specified action) as well as to section 48 (power to impose an assets requirement) but not to section 43(3). That is therefore an indication that the FSA did not intend to use its power under section 43(3) when it gave the Notice. Nor is there anything in the part of the Notice in which the FSA's reasons are given for taking the particular action that suggests a concern to protect those making non-regulated deposits.

49. To the extent that the non-regulated deposits included substantial payments from other group companies (for example £32.4 million paid by KSFIOM), there would also be an inconsistency with paragraph (5) of the Notice, since to make a payment into the Account matching a deposit by a group company would be to create a charge, security interest or arrangement having a similar economic effect over assets of KSF, for which three days' prior notice to, and the written consent of, the FSA is required.

50. Turning from the language of the Notice to its effect, if the judge's reading is right, the Notice would have required KSF to make a payment into the Account corresponding to any deposit received by it from 2 October onwards, including deposits by group companies and by financial institutions. It was submitted to us that this would be inconsistent with the intention apparent from the Notice. Thus, under

paragraph (6)(c) of the Notice, KSF was required to draw down on any open credit lines which it had, in order to establish and maintain its liquidity position. If it was able to do so, it would have received payments from financial institutions which had provided such credit lines. If, however, the Notice has the wide meaning given to it by the judge, it could not freely use any sums so received for liquidity purposes, but would have to make matching payments into the Account. That cannot have been intended by the FSA. The improvement of KSF's liquidity that was desired would have been intended to preserve or enhance its ability to pay its debts as they fell due. To impose a matching requirement to transfer funds into the Account would disable KSF from using any such funds in that way.

51. As against those considerations, the judge relied on the absence of a definition of deposit, and on his view that the FSA would not have intended to prefer regulated depositors over others. The first of those points might be supported by the fact that there are express definitions of "group" and "associate" in paragraph (7) of the Notice, by reference to provisions in FSMA. However, there are different definitions of these words in the FSA Handbook from those in the Act, so that would provide a good reason for including these specific references, a reason which did not apply to "deposits".

52. I do not accept the second point, either. The regulatory scheme is such that the FSA is concerned above all with the interests of regulated depositors. Others, such as group companies, financial institutions or governmental bodies, are expected to be able to look after themselves, including in a crisis such as affected the financial markets in early October 2008. The point of the Notice, as it seems to me, was to protect those making new regulated deposits at a time when, on the one hand, KSF was still able to trade for the time being (if it had not been, its directors would have had to have taken immediate steps towards an insolvency procedure of one kind or another) but, on the other, it was clearly in serious difficulty and might not survive. The intervention was designed to protect those making new regulated deposits for a short time while attempts were made to find a purchaser for KSF or at least for part of its business, as was eventually found in ING for the Edge Accounts, though not for the company as a whole. It was the equivalent, in a sense, of a retail trader setting aside into a trust account sums received on account of orders for goods or the like, at a time of financial difficulty (as in *Re Kayford Ltd* [1975] 1 WLR 279).

53. For that reason, and because it would be inconsistent with the apparent intention of the Notice, as I have mentioned at paragraphs [49] and [50] above, I respectfully disagree with the judge as to the intentions of the FSA in relation to non-regulated depositors. It seems to me that these factors, and the omission from the Notice of any reference to section 43(3) and of any reasoning showing a concern as regards non-regulated activities, show that the Notice was intended to protect regulated deposits only.

54. I do not find the omission of an express definition to be an argument of any strength to the contrary. It is at least as likely that it did not occur to the FSA, when preparing the Notice, that anyone would think that deposits would mean anything other than regulated deposits, in the context of this regulatory action.

55. Mr Tamlyn argued that the failure of the Notice to refer to section 43(3) is of little significance, and pointed out that it did not refer to several other subsections or

paragraphs which were used, such as section 43(2)(a) and 43(4). The latter is a fair point, but it seems to me that the failure to mention section 43(3), and to give any indication in the text of the notice that non-regulated activities were to be controlled in this respect, nor any explanation for that in the reasoning set out in the Notice, is much more significant. Moreover, the inference from this is supported by the inconsistency that there would be between the inclusion of non-regulated deposits and the evident intention to preserve KSF's liquidity so far as possible, and not to favour group companies.

56. For these reasons, I would hold that "deposits" in the Notice has its regulatory meaning. I would allow the appeals of TFL, HMT and FSCS on this point.

57. The consequence of this is that the amount of the payments which should have been, but were not, made into the Account is much less than it would otherwise be. The principal element is the foreign currency deposits, estimated at some £6.2 million. The exact position in this respect is not yet known, because a closer examination will need to be carried out to check what transfers should have been made to the Account, and to reconcile that with the transfers actually made.

58. It is however possible that there will not be a shortfall in the Account because, when transfers were made into the Account, a number of deposits were taken into account which, on this reading, did not need to be reflected by such a payment. These include £5,875,172.55 from group companies and £3 million from a local authority. Both because of these payments in, and because of withdrawals from regulated deposits for which there had been a transfer into the Account, it is necessary to turn to the next issue, as to the right of KSF to withdraw sums from the Account.

Withdrawal from the Account

59. The terms of the Notice envisaged and allowed for withdrawals. Clauses 2(b) and (c) required the payment into the Account of amounts "at least as great" as the initial and subsequent deposits. As regards money in the Account, clauses 2(d) and (e) of the Notice required KSF to:

> "(d) hold money standing to the credit of the account on trust for the benefit of the customers referred to in (b) and (c) above according to their respective interests in it (which shall be the amount of their deposit(s) less any sum withdrawn on their account); and
>
> (e) apply the money standing to the credit of the account solely to repay the initial deposits and the subsequent deposits to those customers."

60. It is common ground that, to the extent that there was a surplus in the Account over the amount to which relevant depositors were entitled, that surplus belongs to KSF. The sums affected by this issue are both the withdrawals referred to at the end of paragraph (d), which KSF honoured by payments out of its own money, and sums paid into the Account which are said to have been paid under a mistake, because they did not match new regulated deposits. The judge held that the latter would have been recoverable for the benefit of KSF generally as money paid under a mistake, if (contrary to his decision) deposits had their regulatory meaning: see his paragraph

119. As regards withdrawals from regulated accounts against new deposits, he held that KSF had an unqualified right of withdrawal, despite the shortfall which, on his reading of deposits, was substantial: paragraph 145.

61. Arguing in support of the judge's conclusion, Mr Gillis for TFL focussed first on the nature of KSF's right of withdrawal or reimbursement. He submitted that KSF's right could be analysed in at least three different ways: under paragraph 2(e) of the Notice, or under a trustee's right of indemnity, or as a beneficiary by analogy with *Re Kayford Ltd*.

62. He submitted that repaying to a relevant customer the amount of a new deposit made by that customer, in respect of which a transfer had been made into the Account, or part of it, was a legitimate use of money in the Account, according to paragraph 2(e). In practice KSF could not repay a customer directly from the Account. It had to repay out of its own resources and then claim recoupment from the Account. I do not doubt that, in principle, KSF was entitled to do that. The question is whether it could do so at a time when it had not yet paid into the Account all that it should have done in order to comply with the Notice, with the result that there was a shortfall in the Account, and the beneficial interests of the beneficiaries would have to abate in order to take account of the shortfall. Mr Gillis submitted that, in order to resolve that issue, it was necessary first to identify properly the basis of KSF's right of reimbursement or recoupment.

63. Mr Gillis' first contention was that KSF had such a right under clause 2(e) of the Notice. Alternatively, he argued that it arose by way of the trustee's right of indemnity out of the trust fund, for which KSF as the trustee had a lien over the fund. In both of these respects he argued that KSF's right took priority over the position of the beneficiaries, and was not subject either to abatement or, worse, to being required to make good the shortfall first.

64. As a fall back he contended that, having honoured a withdrawal from a relevant new deposit, KSF was entitled to be put in the same position as that depositor would have been in, thereby giving KSF the same rights as other depositors. That right might be subject to abatement if there was a shortfall, but would not be subject to making good the whole shortfall first.

65. So far as sums paid in respect of non-regulated deposits are concerned, his position was that these never became part of the trust fund, and that as payer KSF was entitled to recover them as of right, regardless of any shortfall, and without abatement.

66. I must digress briefly to explain how the argument on the latter point developed. The payment of £3 million on account of a deposit by a local authority had been identified before trial and was referred to in the evidence. The additional £5.8 million or so paid in respect of group company deposits was identified to the court on the last of the three days of the trial. No point was raised for argument or decision as regards the £3 million payment until TFL's skeleton argument a few days before the trial. On the judge's decision as to the meaning of deposits, these payments were not incorrect, but he said that, if he had held otherwise as regards the meaning of deposits, he would have held that the £3 million payment would be recoverable by KSF unconditionally as a mistaken payment.

67. Since this was not reflected in the judge's order (because of his decision as to the meaning of deposits) it was not raised in any Appellant's Notice. Equally it was not raised in any Respondent's Notice, even on a contingent basis as a consequence if the regulated meaning of deposits were held to be correct. TFL raised the point in their skeleton argument in support of their appeal, as regards the full amount of some £8.8 million. Issue was not joined with TFL on this in the skeleton arguments submitted by KSFIOM or by HMT and FSCS as respondents to TFL's appeal. In argument before this court, Mr Gillis referred to his written treatment of the point when making his opening submissions on the appeal. The point was not then taken up by other Counsel until Mr Dicker's submissions in reply for HMT and FSCS. That was close to the end of the second day of the hearing, and did not allow time for an oral riposte on the part of Mr Gillis, but the court invited written submissions from him in place of what he would have said orally if there had been time, as well as a final response from Mr Snowden for the administrators.

68. In Mr Gillis' written submission pursuant to that invitation, he objected to the point being disputed in that way and at that stage, it being far too late. Mr Snowden, for his part, while remaining properly neutral as between the parties, invited the court to consider deciding the point, for the assistance of the administrators, and so as to avoid an unnecessary further hearing, whether at first instance or on appeal. The court then directed written submissions (a) on whether the point should be raised and (b) if so on the merits of the point. (At the same time it invited submissions on another point concerning foreign currency deposits, to which I will refer later.) Having had the benefit of written submissions as so invited, including responsive submissions, it seems to me that it is right to decide the point, since it does arise for decision in the light of my view of the meaning of deposit, and because it would be unsatisfactory either to rule on it without having regard to the arguments either way, or to leave it open for later decision.

69. Mr Gillis' argument about the mistaken payments was that the judge was right to hold that, by analogy with *Re Griffiths deceased* [2008] EWHC 118 (Ch), [2009] Ch 162, the £8.8 million payments were made under a mistake, and that accordingly the beneficial interest in the relevant sum never became subject to the trust, but remained KSF's unfettered property, so that it would be entitled to have it back as of right. From what we have been told, it seems that, once this decision had been drawn to the attention of the court and the parties during the hearing, the point was not the subject of much, if any, further debate. In that respect, and in others relating to the issue of withdrawal from the Account, it seems that the points were argued in a significantly different way before us as compared with the debate before the judge. One point on which the judge relied (at paragraphs 148 and 150) was the possibility of double recovery, but all Counsel before us agreed that the possibilities which the judge had identified in this respect could not in fact arise.

70. The point based on *Re Griffiths deceased* applies only to the £8.8 million payments in respect of non-regulated deposits. On the other hand, as the case was argued against TFL, principally on behalf of HMT and FSCS, the same principles should apply to these payments as to the sums matching withdrawals by new regulated depositors. I will therefore address these arguments first, before considering whether the £8.8 million payments are in a different position because of the element of mistake.

71. Mr Dicker, and in alignment with him on this point Mr Tamlyn, relied on a principle known as the rule in *Cherry v Boultbee* (1839) 4 My & Cr 442, for the proposition that because KSF had not complied in full with its obligation to make payments into the Account, so that there was a shortfall, it could not be entitled to take any money out of the Account, on whatever basis, unless and until the shortfall was made good. That rule was recently stated by Chadwick LJ in the Court of Appeal, in *Re SSSL Realisations (2002) Ltd* [2006] EWCA Civ 7, [2006] Ch. 610, at paragraph 79 as follows:

> "(1) The general rule applicable in the distribution of a fund is that a person cannot take an aliquot share out of the fund unless he first brings into the fund what he owes. Effect is given to the general rule, as a matter of accounting, by treating the fund as notionally increased by the amount of the contribution; determining the amount of the share by applying the appropriate proportion to the notionally increased fund; and distributing to the claimant the amount of the share (so determined) less the amount of the contribution."

72. The rule had developed over a long series of cases of different kinds from *Cherry v Boultbee* itself onwards. Several of these cases were cited to us, the latest of which was *Picken v Lord Balfour of Burleigh* [1945] Ch 90. In that case, the rules of a pension scheme set up by a railway company provided for members' contributions to be deducted from their salary, but in practice the deductions made had been less than they should have been. It was held that members were not entitled to receive their full pension without the under-contribution being made good. Those arguing in favour of this proposition relied on *Re Rhodesia Goldfields Ltd* [1910] 1 Ch 239 and other cases in that line. On the other side it was argued that there was no debt due to the fund from the members, the mistaken overpayment (through under-deduction) not giving rise to a debt, and that "the equitable principle exemplified by *In re Akerman* [1891] 3 Ch 212 is not applicable save when the person seeking to obtain benefits due to him from a fund owes a debt to that fund" (see page 95).

73. Lord Greene MR held, first, that the members were under a duty to pay, albeit that the manner of payment was to be by deduction. However, at pages 103-4 he continued as follows:

> "Whether that be so or not, it seems to me that, even if the only method of contribution provided for by the rule is that of deduction, that would not prevent the equitable principle from applying. When that principle is applied the recipient is deemed to have in his hands the money that he is claiming up to the amount of the deficiency in his own payments. Precisely the same thing must apply to the present case even if the only thing that the member contracted to do was to pay by way of deduction. Look at it how you will, this member has not contributed enough. In so far as his contributions are defective in amount, he has under-paid, under-contributed, and it would be, it seems to me, grossly inequitable that a man in that position could be heard to say: "Although I have not made the contributions by way of deduction which I ought to have made, I am now going to say that the application of the equitable rule is not permissible because that would involve making me contribute otherwise than by deduction, which is a thing I never

> contracted to do." That seems to me to be quite a wrong view of the way in which the equitable principle works. My decision does not result in forcing the plaintiffs to make an actual contribution otherwise than by way of deduction. If they come to make a claim then they have to do what is right and bring the fund up to its right level before they can claim to participate in it."

74. Relying on that decision, in particular, Mr Dicker and Mr Tamlyn argued that even if (as Mr Gillis submitted) KSF was not under an obligation enforceable at the suit of the beneficiaries of the trust to contribute the additional funds to the trust fund, nevertheless KSF could not claim money out of the trust fund held in the Account without doing what was right and bringing the fund up to its right level.

75. Mr Gillis' first response to the argument based on this line of authority was that it could only apply if KSF was under an obligation which was, in effect, an asset of the trust, to make the additional payment. In the cases concerned with payments out of or into a deceased's estate, it was a question of collecting in the assets of the estate, including debts due from a beneficiary as debtor to the deceased as creditor, or alternatively, of treating the relevant beneficiary's beneficial entitlement as satisfied, in full or pro tanto, by attributing to it the asset of the estate in the hands of the beneficiary, in the form of the debt owed by him to the estate. That principle, he argued, could not apply in the present case because there was no obligation owed by KSF which could be enforced by the beneficiaries of the trust. The FSA or the Secretary of State might have the right to enforce KSF's obligations under the Notice, for example under section 380 of FSMA, but that was a regulatory matter, not a trust obligation. The judge held that failure to make the required payments was not a breach of trust: see paragraph 156.

76. Moreover, Mr Gillis submitted, as I have already noted, that KSF was entitled to recoup itself for payments made to depositors in respect of their withdrawals against new deposits, by way of the trustee's right of indemnity from the trust fund, for which a trustee has a lien over the fund, which takes priority over any beneficial interest in the fund. Those rights, he said, would be wholly unaffected by the *Cherry v Boultbee* principle.

77. It seems to me that it is unnecessary and wrong to resort to general principles as regards a trustee's right of indemnity in order to resolve this issue. The answer is to be found in the terms of the Notice itself. I accept, in principle, that as and when KSF honoured a withdrawal by a relevant accountholder against a new deposit, by paying the relevant amount out of its own general assets, it would be entitled to be paid the equivalent amount out of the Account. That would give effect to the words in clause 2(d) which define the extent of the beneficiaries' interests in the Account: "(which shall be the amount of their deposit(s) less any sum withdrawn on their account)", and also to clause 2(e) requiring the money in the Account to be applied "to repay the initial deposits and the subsequent deposits to those customers".

78. However, it seems to me that, just as KSF's rights in this respect arose under the Notice, so they were dependent on it having satisfied its obligations under the Notice. Its first obligation, once the Account had been opened, was to credit it with an amount "at least as great as the aggregate value of" the initial deposits. Then it had to credit it with an amount "at least as great as the value of" the subsequent deposits. I accept

that there was great difficulty in working out the exact position, and that the fact (if it was so) that the payments made had fallen short of the amount required was not a matter in respect of which the staff of KSF should be regarded as culpable. However, the fact was (on this assumption) that not as much money as was required under paragraphs 2(b) and (c) had been paid into the Account. The exigencies of the situation were such that the right of withdrawal was not a practical priority at the time, and it can be asserted now, in relation to the facts as and when they are ascertained. Equally, the fact of the shortfall (if it be so) is one of the relevant facts which can be ascertained, and against which KSF's rights and obligations have to be applied and determined.

79. As a matter of principle, this coincides with the reasoning in the latter part of the judgment of the Court of Appeal in *Picken*, cited above. Mr Gillis submitted that that case should be regarded as decided on the narrower ground that there was an obligation on the members to contribute. He then sought to distinguish the present case because the beneficiaries could not oblige KSF to contribute the amount of the shortfall. I accept the latter proposition, and I am prepared to assume that the former may be correct. Even on that basis, I would not accept the conclusion that Mr Gillis sought to draw from these propositions. Clause 2 of the Notice sets out a coherent scheme under which (a) KSF is required to make payments into the Account and (b) it is entitled in some circumstances to withdraw sums from the Account, so as to reflect relevant withdrawals which it has honoured. It seems to me that it is not entitled to do the latter without having first done the former, or having made good any default in respect of the former obligation.

80. This is not the same as to regard the failure to make adequate payments into the Account as a breach of trust, but the effect of that failure is that each member of the class of beneficiaries has an interest in the fund which the fund cannot satisfy in full, and which therefore would have to abate proportionately. It seems to me that, although those beneficiaries cannot oblige KSF to make additional payments into the fund on the basis of a breach of trust, they are entitled to object to KSF taking funds out of the Account without having honoured its prior obligations under clause 2(b) and (c).

81. For that reason, I would respectfully differ from the judge, before whom it seems clear that the point was argued differently. He referred to a comment of Pumfrey J in paragraph 18 of his judgment in *OTC Computers v First National Tricity Finance* [2003] EWHC 1010 (Ch). That seems to me to be a rather general observation, with no indication of the point having been argued as closely as it was before us. I do not regard it as being of assistance in this case.

82. I would hold that, if and insofar as KSF paid withdrawals from relevant new deposits out of its own funds, then in principle it is entitled to be paid the equivalent amount out of the Account, but that it is not entitled to any such payment unless the Account is fully funded so as to cover the amounts due to relevant depositors.

83. In relation to the £8.8 million said to have been paid into the Account under a mistake, I would apply the same principle. KSF's obligation as regards payment into the Account was that defined in clause 2(b) and (c) of the Notice. If the payments which are said to have been made under a mistake resulted in the Account becoming fully funded, then KSF's obligation under clause 2(b) and (c) was fully satisfied. It

would then be entitled to have any surplus back. If it did not have the result that the Account was fully funded, then it seems to me that KSF should not be allowed to assert that, although it made payments into the Account which went towards its obligations under the Notice, some part of that payment should be repaid because KSF made it under a mistake and did not intend thereby to honour its obligations.

84. Mr Gillis' submission is that this cannot overcome the evidence as to KSF's mistake in relation to these categories of payment, and the legal principle applicable because of that mistake, reflected in the decision in *Re Griffiths deceased*. It seems to me that this proposition needs to be examined with some care, in the present circumstances. This case is very different from *Re Griffiths deceased* on the facts. In that case Mr Griffiths had given various assets to trustees, as absolute gifts, but had done so, it was held, under a mistake of fact such that, if he had not been mistaken, he would not have made the gifts.

85. Lewison J held the relevant principle of law to be as set out by the Court of Appeal in *Ogilvie v Littleboy* (1897) 13 TLR 399 (upheld in the House of Lords as *Ogilvie v Allen* (1899) 15 TLR 294), namely that:

> "Where there is no fraud, no undue influence, no fiduciary relationship between donor and donee, no mistake induced by those who derive any benefit by it, a gift, whether by mere delivery or by deed, is binding on the donor. … In the absence of all such circumstances of suspicion a donor can only obtain back property which he has given away by showing that he was under some mistake of so serious a character as to render it unjust on the part of the donee to retain the property given to him."

See Lindley LJ at (1897) 13 TLR page 400.

86. Applying that principle, Lewison J held that some of the gifts were voidable because of the mistake, though others were not. He also held that it was unjust for the donees of the gift to retain the benefit of the gift in the particular circumstances. There was no reason why he should refrain from exercising his discretion to set these gifts aside.

87. Even on the terms of the decision in *Re Griffiths deceased*, it can be seen that the same result does not necessarily follow in the present case. On the premise that the £8.8 million payments were made under a sufficiently important and relevant mistake, KSF can argue from *Re Griffiths deceased* that the transfer was voidable. That would then give the court a discretion to allow KSF to recover the payments, if the mistake would render it unjust for the recipients of the payment to retain the property. What, however, in the circumstances of the present case, would make it unjust for the beneficiaries of the money in the Account to insist that the amount of these £8.8 million payments, insofar as needed to avoid there being a shortfall, should be retained in the Account? It seems to me that the injustice would lie entirely the other way. It would be most unjust for KSF to contend that, although in fact it was obliged under the Notice to make the payment of £8.8 million into the Account, and had not otherwise done so, nevertheless because it included these £8.8 million in the aggregate sums paid into the Account under a relevant mistake, therefore it ought to have the money back, thereby resiling from what would otherwise have been full (or at least better) compliance with the obligations under clause 2(b) and (c) of the

Notice, and leaving the beneficiaries to suffer an abatement of their claims to the money in the Account.

88. In their respective written submissions on this point, Mr Gillis and Mr Dicker sought to focus on the nature of the payments and the nature of the mistake.

89. I have referred at paragraph [19] above to the evidence as to how the payment in respect of deposits on 2 and 3 October came to include an amount reflecting a deposit of £3 million by a local authority. The payment or payments in respect of group deposits of £5.8 million were not dealt with in the evidence, but no doubt it or they came to be made on much the same basis as the £3 million payment in respect of the local authority deposit.

90. It seems to me, on the basis of the evidence about the £3 million payment, that this was not made under a mistake. Rather, when the payment was made, Mr Carrigan was unsure of the position, and made the payment in any event, perhaps in order to be on the safe side, and possibly bearing in mind the obligation under clause 2(b) to make a payment of an amount "at least as great" as the aggregate of the relevant deposits. Lord Hope of Craighead said in *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349 at 410B:

> "A state of doubt is different from that of mistake. A person who pays when in doubt takes the risk that he may be wrong – and that is so whether the issue is one of fact or one of law."

91. Accordingly, the evidence does not seem to me to provide the necessary basis for Mr Gillis' submission that the payment was made under a mistake. Even if it did, the guidance provided by *Re Griffiths deceased* would not lead to the conclusion for which Mr Gillis argued, namely that no beneficial interest in the relevant sums ever became subject to the trust. That would only be correct if the mistake rendered the payment void, whereas *Re Griffiths deceased* held that it would be voidable, and therefore effective unless and until avoided.

92. For those reasons, which turn in large measure on arguments not raised before the judge, I come to a different conclusion from that expressed by the judge. I would hold that KSF is only entitled to be repaid out of the Account to the extent of any surplus over the amounts required to satisfy the interests of the beneficiaries. This is true both of payments in respect of withdrawals from relevant accounts and of any part of the payments into the Account which were calculated so as to reflect deposits that were not, on my reading of the Notice, "customer deposits".

Foreign currency deposits: conversion rates

93. One point which arises under the Notice remains to be dealt with, concerning foreign currency deposits. This arose after the conclusion of the hearing before us.

94. By paragraph 4 of the judge's order made on 15 July 2009, for the purpose of determining the interests of foreign currency depositors in relation to the money in the Account, deposits received by KSF in foreign currency on 2, 3 or 6 October are to be converted into sterling at the exchange rates prevailing on 6 October, and those received by KSF on 7 October are to be converted at the rates prevailing on 7

October. The judge's order did not make any equivalent provision as regards the exchange rate to be applied to withdrawals from relevant foreign currency deposits.

95. In brief written submissions made after the hearing, Mr Snowden for the administrators mentioned this point and invited the court to direct that exchange rates prevailing on 8 October 2008 should be used for the purposes of converting all deposits and all withdrawals. In part that would supplement the judge's order, but in part it would vary it. The administrators explained that they asked to be able to use this one date because of the convenience and logic of using a single date, and in particular the same date as had already been adopted in directions already given by Floyd J to convert foreign currency claims to sterling for the purposes of making distributions under rule 2.86(1) of the Insolvency Rules 1986. The date of 8 October may have been chosen for the purposes of that order because it was the date of the administration order and of the close of KSF's business of taking deposits; that would be logical for any claim to which the Account was not relevant. Figures in evidence suggest that the daily fluctuations in relevant exchange rates at that time were not particularly substantial.

96. The court invited the other parties to indicate whether they were content for the point to be decided and, if so, for any submissions on the point. All parties expressed agreement to the point being entertained by the court. None of Ms Willoughby, TFL, HMT and FSCS objected to the administrators' proposal. KSFIOM, though having itself made some foreign currency deposits at the relevant time, wished to make no submission either way for its own sake on the point. However, before the judge it had represented the interests of creditors who had made foreign currency deposits. It pointed out that the interests of different foreign currency creditors might diverge on this particular point, albeit that the effect either way might well be marginal.

97. Helpfully, however, after discussion with Counsel for the administrators, Mr Tamlyn put forward in his written submissions an argument that might be deployed on behalf of a class of creditors who would suffer as a result of the adoption of the single date of 8 October, rather than the dates specified in the judge's order for deposits and corresponding dates for withdrawals.

98. The argument started from the standpoint that the judge had resolved the position as regards deposits, which had not been appealed, and that, although it would be right to add a provision as regards withdrawals, the logic would be to adopt the same rate as had applied to the corresponding deposit from which the withdrawal was made. This would fit with the terms of the Notice. The conversion of a deposit to sterling is required as at the moment of the corresponding payment into the Account, since only by means of such a conversion can KSF determine (other than by a rough estimate which would have to err on the side of caution) whether the amount paid is "at least as great as" the aggregate of the relevant deposits. The adoption of that date therefore applies for the purposes of determining the extent of the relevant beneficiary's interest in the money in the Account. On that basis it would also be logical to use the same rate of exchange for calculating the amount to be withdrawn. The adoption of a single date for the purposes of distributions in the administration had no necessary or logical connection with the determination of the interests of the beneficiaries in the Account. Administrative convenience is not a relevant or sufficient reason for adopting a date which is not otherwise justified.

99. The administrators put forward contrary arguments in their final responsive written submissions, in favour of a single date of 8 October, not just because of its practical convenience and economy in terms of administrative time and expense, but also on principle, arising, they said, from the essential nature of the interests in the Account derived from the "claims-based" principle accepted by the judge.

100. The point is a narrow one. Under the judge's order, as regards deposits, one or other of two rates is to be used: that prevailing on 6 October (the date of the relevant payments into the Account) for deposits made on 2, 3 or 6 October, and that prevailing on 7 October for deposits made on that day. The administrators' proposal would substitute the rate prevailing on 8 October for both earlier dates, on the basis that this was the date when the position, in effect, crystallised upon the making of the administration order, and when KSF ceased to take deposits. It would also adopt the same date for withdrawals, whenever made.

101. The choice of 6 and 7 October as the relevant dates for conversion of deposits to sterling is based on the fact that it was on those dates that payments were made into the Account. Nor was it a matter of chance that payments were made on those dates; they had to be so made if the Notice was to be complied with. The fact that KSF did not consciously take the foreign currency deposits into account when calculating the payments into the Account does not matter for this purpose, because it was at those times that funds were paid into the Account, whereupon the relevant depositors acquired beneficial interests under the trust. The basis of the calculation of the amounts paid in does not seem to me to be relevant for this purpose.

102. In order to quantify and give effect to those beneficial interests, in relation to a sterling fund, foreign currency deposits need to be converted to sterling. A foreign currency depositor had to compete with sterling depositors (if the Account was not fully funded) or with KSF's general creditors (if the Account was fully funded and the question was how large any surplus might be). For that purpose its claim had to be expressed in sterling, despite the fact that, as between the depositor and KSF alone, the depositor was entitled to be paid, and KSF was entitled to pay, in the foreign currency, thereby ignoring any effect of a currency fluctuation between the date of the deposit and the date of the withdrawal, whichever way it might go. As it seems to me, it was correct for the judge to adopt the dates of the payments into the Account as the appropriate dates for conversion for this purpose. I would therefore reject the administrators' argument in favour of 8 October, despite its greater convenience.

103. So far as withdrawals are concerned, three periods could be relevant.

i) If a deposit was made on 2 October against which a withdrawal was made on 3 October, then the amount which should have been paid into the Account under clause 2(b) of the Notice would have been the amount of the deposit net of the withdrawal. Conversion in that case would therefore be covered by paragraph 4 of the judge's order, because it is not necessary to convert the withdrawal separately.

ii) If a deposit was made on 2 or 3 October and a withdrawal was made against it on 6 October, then the deposit should have been reflected by the payment into the Account on the morning of 6 October, converted to sterling as at 6 October under the judge's order, and it seems to me that there is no reason to adopt a

different exchange rate from that prevailing on the same date for the withdrawal.

iii) If a deposit was made on 2, 3 or 6 October, and a withdrawal was made against it on 7 October, the deposit will be converted to sterling as at 6 October under the judge's order, but the question is whether the withdrawal should be converted to sterling as at 6 October, for consistency, or as at 7 October, representing the then value, in sterling, of the sum withdrawn, for the purposes of calculating the depositor's net interest in the Account (if any). I cannot see any principled basis for adopting 8 October for this purpose.

104. The application of a different exchange rate for the withdrawal as compared with that used for the deposit could produce artificial results. If the withdrawal (in the currency of the particular account) was in fact of the whole of the new deposit, so that the particular depositor no longer had an account with KSF, or at any rate did not have an account which included any credit for a deposit made on or after 2 October 2008, then, as it seems to me, that person would have no claim against the Account. If, on the other hand, the withdrawal (in the currency of the account) was of only part of the amount of the new deposit then that accountholder would have both a claim against KSF and a beneficial interest in the Account. The use of exchange rates applicable on three different dates (6 October for the deposit and 7 October for the withdrawal, in terms of the rights within the Account, and 8 October in terms of the claim against KSF as such) could produce oddities and anomalies, whether in favour of the accountholder or of KSF.

105. Those consequences would be avoided, or at least reduced, by using the same rate for the conversion of a withdrawal as that which was used for the corresponding deposit. I dare say that anomalies could still arise from fluctuations in exchange rates, and I can see that it would be easier for the administrators if a single date could be used for all these purposes. But the use of 8 October for the purposes of claims in the administration under Floyd J's order has nothing to do with the issues concerning interests in the Account.

106. It seems to me that the correct approach would be to use the same rate to convert a withdrawal as is used to convert the corresponding deposit. Thus, if the deposit was made on 2, 3 or 6 October, and withdrawn on any day up to and including 7 October, the relevant currency rate is that prevailing on 6 October. The rate prevailing on 7 October would only be relevant for a withdrawal if the corresponding deposit was made on the same day. I do not know whether, in relation to a foreign currency account, it was possible for a deposit to be made on 7 October and a withdrawal against that deposit to be made within the same day nor, if it was possible, it happened in fact. If that could and did happen, the accountholder's interest in the Account would be measured by reference to the net position at the end of the day, so that a single rate of exchange would be applied in any event. (In practice, as it seems to me, in such a case withdrawals on that day could properly be set against deposits made that day, in whatever order they happened during the day.)

107. In terms of quantifying the beneficial interests in the Account, which is the presently relevant purpose, it seems to me that the dates adopted by the judge as regards deposits were correct. I accept that it is appropriate to add a suitable provision for the conversion of withdrawals, despite the fact that this was not raised in terms in any

Appellant's Notice. (Nor would I have been deterred from altering the judge's direction as to conversion of deposits, if I had been persuaded that it was not correct, by the fact that the point was not taken in an Appellant's Notice.) The provision that I would add in relation to withdrawals is that any withdrawal made in respect of a foreign currency deposit made on or after 2 October should be converted to sterling at the same rate as falls to be used for the conversion of the corresponding deposit.

108. For those reasons, I would not vary paragraph 4 of the judge's order except to supplement it in relation to withdrawals as indicated above.

109. This result may have practical implications for the conduct of the administration in relation to which the court might be able to give directions which would be of assistance. Any application for such directions should be made to the Companies Court, rather than to this court.

The transfer of liabilities to ING: the Order

110. The remaining issues turn on the Order rather than on the Notice. I must therefore explain the transaction with ING, describe the Order and the legislation under which it was made, and say something about FSCS.

111. ING assumed KSF's liabilities to the holders of Edge Accounts by way of a novation, but without the agreement of the depositors. Such a transfer of these liabilities from KSF to ING could only be achieved by the use of special legislation. In return for ING taking over these liabilities, HMT and FSCS between them agreed to pay to ING the amount of the liabilities, less £5 million.

112. All of KSF's account holders whose deposits were within the regulatory meaning of deposit, discussed above, were protected against the risk of KSF's failure by FSCS under Part XV of FSMA. Many, perhaps all, Edge Accounts were regulated deposits. However, the protected element was limited to £50,000, having just been increased from £35,000 with effect from 7 October 2008 by virtue of an amendment to the rules about compensation which are set out in the compensation sourcebook (known as COMP) within the FSA handbook. (The amendment, made by FSA on 2 October by the Compensation Sourcebook (Amendment No 8) Instrument 2008, raised the upper ceiling on compensation in respect of protected deposits, and also obliged FSCS to obtain an assignment from claimants for compensation.) Moreover, the procedure whereby depositors could obtain compensation was potentially slow and time-consuming, and in the meantime they would be out of their money.

113. HMT saw a risk that, if KSF's protected depositors had to wait for their compensation until claims were made and processed under FSCS, this would cause yet greater instability in the UK financial market than already existed; that is apparent from the recital to the Order. Accordingly the approach adopted was that FSCS would become liable to pay to ING the amount of compensation that it would have been liable to pay to the depositors in respect of Edge Accounts: see article 14(1)(a) of the Order (set out below). HMT would be liable to pay to ING the aggregate amount of the transferred liabilities, less the amount payable by FSCS, and less £5 million: see article 14(1)(b). The deduction of £5 million represented, in effect, the price that ING agreed to pay for entering into the transaction and obtaining the additional customers. As a result,

Edge Accounts were taken over by a creditworthy bank, and accountholders (whether with instant access accounts or term accounts) could expect their deposits to be safe.

114. The transaction was effected, so far as is relevant for present purposes, by the making of the Order. It was made under various powers conferred on HMT by the 2008 Act, which had been passed in February 2008. The powers created by that Act enable HMT to effect transfers of the property, rights and liabilities of a UK deposit-taker if, among other things, it appears to HMT that making the order is desirable for the purpose of maintaining the stability of the UK financial system in circumstances where they consider that there would be a serious threat to its stability if the order were not made: see section 2. By section 6 the transfer may be to either or both of a company owned by HMT or the Bank, and any other company. Section 12 provides for consequential and supplementary provision to be made by an order under the Act, and Schedule 2 extends still farther the potential scope of an order under section 6.

115. The Order provided first of all for the transfer of the liabilities (subject to exceptions presently irrelevant) of KSF in respect of Edge Accounts to a company to which I will refer as DME, a wholly owned subsidiary of the Bank. This transfer took effect when the Order came into force, at 12.15pm on 8 October 2008. At that time DME had the same rights in relation to each holder of an Edge account as it would have if KSF's terms of business applied. DME did not have an express authorisation under FSMA, so the Order provided for it to be an exempt person for the purposes of that Act. It did not in fact take deposits, but it was important that it should be an authorised person, for the purposes of the scheme of the Order.

116. Immediately after the transfer to DME, the rights and liabilities which had been transferred to DME were transferred to ING. ING then became liable to pay to the transferred depositors any accrued interest on the transferred accounts and any interest accruing thereafter on the accounts, and had the same rights in relation to accountholders as if KSF's relevant terms of business applied. (The administration order in relation to KSF was made later that day.)

117. The part of the Order which is most directly relevant for present purposes is Part 4, dealing with FSCS. The Order also contained provisions dealing with the administrators, and with consequential matters, to which I need not refer. The intense time pressure under which, I have no doubt, the Order was prepared and made led to a curious error in the heading to article 13, which is the first in Part 4, but is headed "application of Part 3". It provides that "This Part" (clearly meaning Part 4) applies in given circumstances, namely where KSF was in default for the purposes of provisions relevant to FSCS.

118. The issues on this part of the appeal turn mainly on provisions in articles 14 and 15 of the Order, though reference was also made to some paragraphs of article 16. These three articles are as follows:

> "Sums to be paid to ING following the second transfer
>
> 14(1) The following liabilities arise at the second transfer time
>
> (a) the FSCS is liable to pay (as soon as practicable) to ING an amount equal to the amount that eligible claimants would,

immediately before the effective time, have been entitled to claim from the FSCS in respect of claims against Kaupthing in relation to relevant protected deposits; and

(b) the Treasury are liable to pay (as soon as practicable) to ING an amount equal to the aggregate amount of the liabilities transferred to ING under the second transfer less the amount specified in sub-paragraph (a) and less £5,000,000,

and the Treasury shall subsequently make the necessary adjustment such that Kaupthing obtains the benefit (net of all costs and liabilities incurred by Deposits Management (Edge)) in connection with the first or second transfer or its obligations under this Order of the reduction of £5,000,000 referred to in sub-paragraph (b).

(2) For the purposes of paragraph (1)(a), if the quantification date for a claim would have been a date other than the date on which Kaupthing was determined to be in default for the purposes of section 6.3 of the COMP Sourcebook, the amount that an eligible claimant would have been entitled to claim from the FSCS is the lesser of

(a) the amount which the FSCS quantifies as being the value of that claim as at immediately before the effective time; and

(b) the amount which would have been payable at the quantification date, if different, for that claim.

(3) In paragraph (2), "quantification date" has the meaning given in rule 12.3.1 of the COMP Sourcebook.

(4) As soon as practicable after the second transfer time

(a) Kaupthing shall estimate the aggregate amount of the transferred liabilities;

(b) the FSCS shall pay to ING the amount it is liable to pay under paragraph (1)(a) as estimated by the Authority; and

(c) the Treasury shall pay to ING an amount equal to the amount estimated by Kaupthing in accordance with sub-paragraph (a) less the amount estimated by the Authority in accordance with sub-paragraph (b) and less £5,000,000.

(5) From time to time

(a) the FSCS may revise the estimate of its liability under paragraph (1)(a); and

(b) Kaupthing may revise the estimate of the aggregate amount of the transferred liabilities.

(6) In consequence of paragraph (5), the FSCS, the Treasury and ING shall make such corresponding payments to each other as are necessary to ensure that the FSCS and the Treasury have each paid to ING the amount required (and no more than the required amount) to meet their liability under paragraph (1).

(7) If at any time after the effective time Kaupthing is placed into administration, the references to Kaupthing in paragraphs (4) and (5) are to be treated as references to the administrator.

(8) The liability referred to in paragraph (1)(a) shall be assessed by the FSCS and, in doing so, the FSCS may calculate, by any methodology or approach it considers appropriate, the total amounts of compensation that would have been paid to all eligible claimants if (and to the extent that) it considers that the costs of ascertaining the entitlement to and the amount of compensation by reference to each eligible claimant would exceed or be disproportionate to the benefit of doing so.

Payment to ING to constitute payment of compensation for the purposes of the Financial Services Compensation Scheme

15. For the purposes of Part 15 of the 2000 Act (the financial services compensation scheme), the COMP Sourcebook and the FEES 6 Chapter (including, without limitation, the power of the FSCS to impose levies)

> (a) all payments by the FSCS to ING under article 14 shall constitute the payment of compensation to each eligible claimant under the Financial Services Compensation Scheme in accordance with their respective entitlements in respect of claims against Kaupthing for relevant protected deposits;
>
> (b) in relation to a relevant protected deposit, each eligible claimant
>
> > (i) is deemed to have made an application for compensation for the purposes of rule 3.2.1(1) of the COMP Sourcebook; and
> >
> > (ii) is deemed to have accepted an offer of compensation made by the FSCS and to have received payment of such compensation for the purposes of rule 11.2.1 of the COMP Sourcebook,

and, accordingly, an eligible claimant has no right to claim, and the FSCS has no obligation to pay, for a relevant protected deposit any further compensation under the Financial Services Compensation Scheme in respect of the default of Kaupthing determined by the Authority under section 6.3 of the COMP Sourcebook.

Liability of Kaupthing to the FSCS and the Treasury

16(1) Kaupthing is liable to the FSCS in respect of an amount equal to the amount which would have been provable in the administration of Kaupthing in respect of the transferred liabilities had this Order not been made and had Kaupthing been placed in administration immediately before the effective time.

(2) The FSCS shall pursue recoveries from Kaupthing in respect of the liability under paragraph (1) to the extent reasonably practicable.

(3) Subject to paragraph (4), if an eligible claimant had, in relation to a relevant protected deposit, a liability to Kaupthing which would have been capable of being set-off against a liability of Kaupthing to that claimant in an administration or liquidation of Kaupthing (if that liability had not been transferred), the amount which the FSCS is entitled to recover in the administration or liquidation shall be taken to be the sum of—

(a) the amount of the reduction in the depositor's liability to Kaupthing as a result of the application of the set-off; and

(b) the amount which would have been recovered in respect of the balance of the claim (if any) provable in the administration or liquidation of Kaupthing.

(4) Paragraph (3) applies only to the extent that its application does not have the effect that the other creditors of Kaupthing are in a worse position than they would have been had the set-off been applied.

(5) The FSCS shall determine the proportion of any amount which it receives or recovers from Kaupthing which is properly attributable to each type of liability described below and shall promptly, on receipt, account for that receipt or recovery as follows—

(a) in full to the Treasury, to the extent that—

(i) the receipt is attributable to a transferred liability; and

(ii) the person to whom such a transferred liability is owed would not have been entitled to make a claim for compensation from the FSCS immediately before the effective time;

(b) by reference to the relevant proportion, to the extent that—

(i) the receipt is attributable to a transferred liability;

(ii) the person to whom such a transferred liability is an eligible claimant; and

> (iii) the amount of such liability exceeds the maximum compensation that the eligible claimant would have been entitled to claim from the FSCS immediately before the effective time;
>
> and where the receipt is attributable to a transferred liability owed to an eligible claimant in relation to a relevant qualifying deposit and the amount of such liability is equal to or less than the maximum compensation that the eligible claimant would have been entitled to claim from the FSCS immediately before the effective time that amount shall be for the account of the FSCS.
>
> (6) In paragraph (5), the "relevant proportion" is the proportion of the total liabilities which arise under article 14(1) for which the Treasury are liable.
>
> (7) If Kaupthing is in administration, the liability incurred under paragraph (1) shall not be treated as an expense of the administration under paragraph 99(3) of Schedule B1 of the 1986 Act or rule 2.67 of the Insolvency Rules.
>
> (8) Nothing in this Part shall have the effect that the FSCS recovers less than it would have recovered if this Order had not been made."

119. The most important of these provisions for present purposes is article 15. This has express effect both as regards claimants under FSCS and as regards the power of FSCS to raise levies from contributing undertakings. Payments by FSCS to ING are to constitute the payment of compensation under FSCS in respect of claims for relevant protected deposits with KSF. Eligible claimants are treated as having applied for compensation and to have accepted an offer of compensation for the purposes of FSCS. Eligible claimants have no further right to compensation and FSCS is not obliged to pay any further compensation in respect of any such protected deposit.

120. Depositors who have to rely on the normal procedures under FSCS in order to obtain compensation have to complete an application form which provides expressly for the assignment of the rights of the depositor, in respect of the amount of their claim, to FSCS. The standard application form includes the following terms:

> "I/We understand that FSCS will, on paying any compensation to me/us take over my/our rights and claims against the Bank and against any other party in accordance with the terms of my/our agreement and acknowledgment contained in section (E) of this document and that thereafter I/we will be entitled only to the benefit of those rights and claims that might be specified in section (E)".

121. In turn section (E), referred to, is as follows:

> "(1) I will accept the offer of compensation in full and final discharge of settlement of the obligations of FSCS under the relevant rules and laws. I understand that any compensation is payable by

FSCS to fulfil my entitlement in compensation from FSCS in respect of the Claim.

(2) All my rights in against the Bank in respect of the Claim will pass to it and be assigned to FSCS absolutely on payment of compensation (or any part of it).

(3) All my rights against any other person which constitute a Third Party Claim as defined in paragraph 12 below will pass to and be assigned to FSCS absolutely on payment of compensation (or any part of it).

(4) On payment of compensation (or any part of it) I will no longer have the right to make any claim against the Bank or any other body in respect of the Claim or a Third Party Claim and that the right to make any such claims will be vested in FSCS. I further acknowledge any sums that would otherwise be payable to me in respect of the Claim (including any dividend or other payment in liquidation or compromise with the creditors or schemed arrangement) or a Third Party Claim will be paid instead to FSCS.

(5) I will not exercise any right or remedy that I may have or retain against the Bank or any other person arising out of or in connection with the Claim or any Third Party Claim namely

- To rescind, set aside, avoid or otherwise alter any contract or obligation;
- To set off or reduce liability in respect of such a contract or obligation
- Any right or remedy that is either personal to me or cannot be assigned or both

(6) If I recover any money or assets in respect of the Claim or in respect of a Third Party Claim I will immediately pay it or transfer it or them to FSCS.

(7) If the payment of compensation should not have been made for any reason, I will immediately fully repay (or if compensation had been paid to a Third Party for my benefit, get repaid) to FSCS any compensation paid, without any deduction or set-off, plus interest."

122. Thus when FSCS has paid to a depositor the compensation due under the Scheme, it becomes entitled to all the depositor's rights against the bank and is in effect substituted as the bank's creditor for the relevant amount. If the deposit had a right to security by way of an arrangement such as the Account, those rights would also be assigned to FSCS.

123. Before 7 October 2008 FSCS had a discretion to require such an assignment from the depositor. According to the evidence it did so invariably. As from that date,

however, as mentioned above at paragraph [112], the rules of the scheme were changed so that FSCS was obliged to impose that condition.

124. The first of the issues arising under the Order is whether its terms were such that FSCS obtained an assignment of the rights of the Edge accountholders, to the extent of their rights under the scheme, as it would have done if the normal procedure had been followed. The judge held that they did effect such an assignment.

125. The second issue arises only if the answer to the first is otherwise. It is whether, in that case, FSCS and HMT are entitled to the benefit of the depositor's rights against KSF by way of subrogation. The judge held that they would not have been so entitled, if the question had arisen.

Assignment

126. If the ordinary process under FSCS had been followed, the depositor would have assigned to FSCS all his claims against KSF in return for receiving payment of the compensation offered and accepted. The judge held that the effect of the Order was that depositor's rights were assigned to FSCS. TFL challenges that result by its appeal. On its behalf Mr Gillis pointed out that article 15 said nothing at all about assignment, whereas it could easily have included an express provision for a deemed assignment. He also argued that if the normal procedure was applied by analogy, an assignment would take effect when FSCS paid the compensation, that under article 15 this was treated as taking place when FSCS made a payment to ING, but that by then, under the Order, the liability had been assigned to ING, so that the depositor would have no continuing claim against KSF which could be assigned to FSCS. Article 16 gives FSCS the right to prove in the administration of KSF for the liabilities transferred, but that provides no rights as against the Account. Accordingly, he submitted, FSCS acquired no rights as against the Account, even though it would have done under the normal procedure. He submitted that it was wrong to place any reliance on what would have happened under the ordinary procedures of FSCS.

127. Mr Gillis submitted, rightly, that these points turn on the proper interpretation of the Order in the context of the relevant surrounding circumstances. The subjective intention of HMT at the time the Order was made is not relevant for this purpose.

128. I have set article 15 out above just as it appears in the Order as printed, because otherwise one of Mr Gillis' arguments may not be so clearly appreciated. He said that the closing part of the article, beginning "and, accordingly", was a statement of the consequences of paragraphs (a) and (b), and should be taken to be exhaustive as such. It does not mention assignment, and therefore article 15 should not be taken to provide for any assignment.

129. As regards the relevance (or lack of it) of what would have happened if the ordinary processes of FSCS had been applied, he argued that these had been displaced, for what was no doubt seen to be good reason, by the provisions of the Order, and that it should not be assumed that an analogy with what would have happened otherwise was of any relevance. Given that a special process was to be established by the Order, all depended on the true interpretation of that process as defined.

130. Despite Mr Gillis' arguments, it seems to me that the judge was right to hold that FSCS did obtain, by implication, an assignment of the claims of protected depositors against KSF, including their rights in respect of the Account. I also agree with the judge that it is legitimate and correct to have regard, as part of the matrix of fact in relation to the Order, to what would have happened under FSCS in the ordinary way, including to the fact that the terms of the Scheme had just been changed, in the way I have described, taking effect on the day before that on which the Order was made. The process established by the Order was, as has been said, a proxy for the normal operation of FSCS. It was an improvement on the normal process for protected depositors, because they did not have to make claims, and because the compensation that would have been payable to them was instead payable to ING, as part of the consideration for ING taking over KSF's liabilities in respect of the deposits, whereby depositors arrived, automatically, at a more satisfactory position than they would otherwise have been in, by having a creditworthy bank substituted as their debtor.

131. For the purposes of FSCS itself, and in particular as regards the ability to levy calls on other institutions liable to fund the Scheme, the position under the Order was to be just the same as if potential claimants had applied for, and had received an offer of, compensation, which they had accepted and had been paid to them. Like the judge (see his paragraph 192) it seems to me that this statutory analogy with the operation of the normal scheme brought with it the other incidents of the normal scheme. Undoubtedly, it was to be applied by reference to the newly raised limit on the claim for compensation. It seems to me that it should also be construed in the light of the other change made by the same instrument as effected that change, namely the obligation on FSCS to require an assignment of the claimant's rights.

132. I do not accept that the assignment of rights should be regarded as having been excluded, even though in the normal operation of FSCS it would have been obligatory. The failure of the Order to make express reference to assignment does not impress me as an argument of any weight, especially in the context of the Order which we know was prepared under severe pressure of time, in order to cope with an extreme crisis. That is apparent from the evidence before the court, and is confirmed by internal evidence in the Order itself: see the point about article 13 to which I have referred at paragraph [117] above.

133. Mr Gillis' argument as regards timing also needs to be considered in the context of the text and operation of the Order. He argued that, even if the claimants were deemed to assign their rights to FSCS, as they would have done under the normal documentation, that would be of no avail to FSCS. In a normal case the assignment took effect only on actual payment to the claimant. That is quite understandable in such a case, because, under the normal process which involves a claim, an offer and an acceptance of that offer, it is not certain that a claimant will obtain or receive payment, and until he does, there is no reason why he should lose his rights against the bank or any other party in favour of FSCS.

134. In the present situation, however, although payment is not treated by article 15(a) as taking place until FSCS makes any actual payment to ING, the significance of the date of such payments is to be understood by reference to the levy-making power. FSCS became liable to make such payments to ING at the time of the transfer from DME to ING under article 14(1)(a), but no doubt it did not make any actual payment until some time later. The provisions of articles 14(4)(a), 14(5)(a), 14(6) and 14(8)

are all directed to the process of working out what FSCS is to pay. Article 14(4)(b) provides for payment on account on an estimated basis. Thus it is likely that there will be at least two payments by FSCS to ING, the first being on an interim basis, in respect of any Edge Account. From the time of the transfer, however, the protected depositor's rights were transferred automatically from KSF to ING. After that time he would have no rights against KSF that could be assigned to FSCS. That is the moment at which he receives the effective benefit of his compensation payment. As it seems to me, that is the moment at which he should be treated, by analogy with the normal procedure, as assigning to FSCS his claims against KSF and any related claims, in particular those in respect of the Account. The provision for payment to ING in at least two stages also supports the argument that the date or dates of payment to ING have no relevance to the assignment.

135. Article 15 serves several purposes. One is to establish that potential claimants have received all (if any) compensation due to them, so that there is no residual claim outstanding on their part against FSCS. Another is to ensure that, for the purposes of FSCS' power to levy funds, payments of compensation are treated as having been made (and to determine, for these purposes, the time when they were made). I do not accept Mr Gillis' contention that the concluding lines of article 15 set out comprehensively the effect of the article. They do set out some consequences of the previous provisions of article 15, but I see no reason to suppose that they were intended to be exhaustive.

136. Moreover, given the overt concern as regards FSCS' levy powers, it would be surprising if the deemed process was less favourable for the levy-payers than the normal process would have been, by reason of not obtaining for FSCS an assignment of rights in respect of the Account. The failure to obtain that right would leave FSCS without one way of mitigating its outlay by way of compensation, and would therefore increase the burden on the levy-payers to make good the fund available for compensation payments.

137. Mr Gillis also relied on article 16(1) which he said would not have been necessary if there was an assignment, and (on the other hand) if there was intended to be an assignment, it was odd that it was not mentioned here. As to that, it seems to me that it was natural and appropriate, and it may well have been necessary, to set out a specific provision as to the basis of liability on the part of KSF on which FSCS could prove in the imminent administration of KSF, especially as HMT had provided part of the funding. Article 16(2) shows that FSCS is intended to pursue its right of recovery against KSF so far as it reasonably can. Article 16(3) amplifies the ability of FSCS to claim against KSF in an administration or liquidation, while paragraphs (4) and (7) of the article protect other creditors. Article 16(8) shows that FSCS' rights of recovery, as they would have been but for the Order, are a relevant comparison. That seems to me to emphasise the relevance of considering the position as it would have been under the normal processes of FSCS, and the aim of not putting FSCS in a worse position than it would have been in that case, as regards recoveries. The remainder of article 16 is concerned with accountability as between FSCS and HMT for any recoveries.

138. In my judgment, the normal FSCS procedure and documentation is relevant in construing the Order. Reference to that material shows that, on making an application to FSCS and receiving compensation as a result, a claimant must assign his rights against the relevant institution, and any connected rights, to FSCS. That assignment

takes place, in the ordinary way, on payment of the compensation, because that is the moment when the position is crystallised in an ordinary case, so that the depositor loses his rights against the relevant institution, on receiving payment from FSCS. In the proxy version of the compensation process which is established by the Order, the depositor gets the full benefit of the compensation at the moment of the transfer to ING. It seems to me that it is at that moment that the features of the normal process that accompany payment should be treated as occurring, including the assignment to FSCS of the depositor's rights against KSF and, where relevant, in relation to the Account as well.

139. I therefore agree with the judge that FSCS does have the benefit of an assignment from relevant Edge depositors of any interest they may have in the money in the Account. My reasoning is not in all respects the same as his, for example as to the reason why the provision of the Order as to the time at which FSCS is to be treated as paying the relevant compensation does not mean that the assignment takes place at the same time, too late to carry any right in relation to the Account. Nor would I place reliance on HMT's subjective intention. But I have come to the same conclusion as he did, for largely the same reasons.

Subrogation

140. I also agree with the judge that, if FSCS did not have the benefit of deemed assignments from depositors under the Order, neither it nor HMT could make any claim by subrogation. If, contrary to the conclusion I have reached, the terms of the Order, prepared and promulgated unilaterally by HMT under the 2008 Act, were not such as to provide for assignments of rights, or to make any equivalent provision for the benefit of either or both of FSCS and HMT, I see no reason why the intervention of a doctrine such as subrogation should assist HMT and FSCS to a result which was not achieved by the Order. The judge said much the same at paragraphs 204 and 205.

141. Mr Dicker's argument on this point can be summarised briefly as follows. KSF, or its depositors other than holders of Edge Accounts who had interests in the Account, were enriched by reason of the discharge of KSF's Edge Account liabilities by the Order. That enrichment came about by reason of payments by HMT and FSCS. The enrichment is unjust because KSF was the party primarily liable to make the payments. As regards the relevance of the Order, assuming (for this purpose) that it did not give FSCS an assignment of the relevant depositors' rights, he argued that the question was whether it was positively intended to confer only unsecured rights on HMT and FSCS, and that this could not be shown.

142. It seems to me that the argument falls at the last stage, even if not before. The effect that the Order had, on its true construction, should be taken to be that which its maker (HMT) intended. I do not accept that the subjective intention of HMT is relevant in this respect. If the Order did not give FSCS or HMT any rights against the Account, then I can see no basis on which those parties can assert that their failure to obtain any such rights is unjust.

143. Mr Gillis advanced other objections as well to the argument based on subrogation. Since the point is only theoretical if I am right as to assignment, I do not consider it necessary to go into the subrogation point at any greater length.

Disposition

144. For the reasons given above, I would dismiss the appeal of Ms Willoughby against the judge's declaration in paragraph 3 of his Order, which I consider to be correct. I would allow the appeals of TFL, HMT and FSCS in relation to his declaration in paragraph 2 and hold, instead, that "deposit", in the Notice, has its regulatory meaning (in whatever currency the deposit is made) and that "customer" has the corresponding meaning. I would also allow the appeals of Ms Willoughby, KSFIOM, HMT and FSCS against his declaration in paragraph 6 of the Order, as to KSF's right to withdraw sums from the Account. Instead I would hold that KSF is not entitled to withdraw sums from the Account, whether in respect of withdrawals by relevant customers against deposits which are the subject of paragraph 2(b) and (c) of the Notice, or in respect of sums paid into the Account which were calculated by reference to deposits other than regulated deposits (in particular the £3 million deposited by a local authority and the £5.8 million deposited by group companies), unless the Account is fully funded as regards the entitlement of regulated depositors, and then only to the extent of the surplus. I would not alter the judge's declaration in paragraph 4 of the Order as regards the conversion rate for foreign currency deposits except to add a declaration that any withdrawals against such deposits should be converted from sterling at the same rate as is to be applied to the corresponding deposit. I would dismiss the appeal of TFL against the judge's declaration in paragraph 7 as to the assignment of depositors' rights. For my part, I would also dismiss HMT's and FSCS' appeals against his declaration in paragraph 8 about subrogation. Since Sedley LJ and Thomas LJ have reservations on that last point, and since it does not arise in practice, given the decision on assignment as to which we do all agree, the judge's order should be varied by deleting the declaration about subrogation, but without inserting any other declaration in its place.

Lord Justice Thomas

145. I am deeply indebted to Lloyd LJ for the clear and detailed analysis of the issues. I agree with the judgment and order proposed. I have one minor reservation in relation to the issues relating to the transfer of liabilities. As the claims of the Edge account holders were clearly assigned for the reasons given by Lloyd LJ at paragraphs 126 to 139, I would prefer to express no view on Mr Dicker QC's argument on subrogation which does not therefore arise for decision.

Lord Justice Sedley

146. I too agree with the judgment of Lloyd LJ in every respect, save that like Thomas LJ I would prefer to reserve my view on what has become the academic question of subrogation.