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Client Alert Commentary

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FCA Fails to Find Its *Watersheds* Moment in *Adams v. Options SIPP UK LLP*

The English High Court's findings are likely to have wide implications, not just for SIPP operators but for all regulated firms.

Key Points:

- Regulatory obligations are not intended to take precedence over contractual terms and should be read in light of what the contract says.
- Investors cannot rely on FCA guidance and thematic reviews to make a claim under FSMA.
- Mere introducers need not be regulated.

On 18 May 2020, the English High Court handed down its long-awaited judgment in *Adams v. Options SIPP UK LLP (formerly Carey Pensions UK LLP)*,[1] finding in favour of the self-invested personal pension (SIPP) operator, Carey Pensions UK LLP (Carey), renamed subsequently as Options SIPP UK LLP. Although the FCA was not a party to the litigation, unusually, it sought permission to intervene and make submissions on the interpretation of regulatory provisions and related guidance considered in the case. This landmark decision will be of particular interest to SIPP operators as well as to regulated firms and the wider financial services industry more generally, given the Court's rejection of the FCA's submissions.

Background

In 2011, Mr Adams was contacted by an unregulated introducer, CL&P Brokers (CL&P), with regard to an investment in Store First, a company that sold leaseholds in storage pods, which would provide a rental income and potential capital growth. The investment was to be held in a SIPP provided by Carey. CL&P introduced Mr Adams to Carey. Carey had terms of business with CL&P that expressly prohibited CL&P from advising prospective members. Following his introduction to Carey, Mr Adams proceeded to set up a SIPP with Carey, and to transfer his existing pension. In June 2012, Mr Adams instructed Carey to make the investment in Store First.

Mr Adams' investment in Store First did not perform as he had hoped. Mr Adams therefore brought a claim against Carey, seeking damages and to unwind his contract with Carey.

Mr Adams alleged that Carey had failed to "act honestly, fairly and professionally in accordance with the best interests of its client", in accordance with the Conduct of Business Sourcebook Rules (COBS), in particular rule 2.1.1 (the Client's Best Interests Rule) (the COBS claim), by:

- Accepting the investment in Store First
- Providing the SIPP
- Failing to implement FCA guidance
- Failing to warn Mr Adams of the risks and that the SIPP investment in Store First were "manifestly unsuitable"

Mr Adams also claimed that there was a breach of the regulatory regime in establishing the SIPP as a result of the acts of CL&P providing advice to Carey as an unauthorised person. Mr Adams argued that CL&P, as an unregulated introducing broker, was in breach of s.19 of the Financial Services and Markets Act 2000 (FSMA) in carrying out a regulated activity within the meaning of articles 25 and 53 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544) (RAO). Therefore, the contract establishing the SIPP was "unenforceable" under s.27 FSMA (the s.27 Claim).

Just weeks before the trial, the FCA intervened in the claim. The FCA was granted permission to make written and oral submissions at trial regarding its interpretation of its COBS rules, the RAO, and FSMA.

The FCA suggested in its submissions that the Client's Best Interests Rule could not be limited by the scope of the parties' contract. The FCA also submitted that COBS 2.1.1R imposes an obligation to undertake an assessment in respect of both the proposed introducer and the proposed investment and that the firm may refuse to proceed with the investment in an appropriate case, without having to give advice to the investor. In addition, the FCA disagreed with Carey and submitted that COBS 2.1.1R "does include a duty not to accept into a SIPP an investment of a kind that is inappropriate for any SIPP investment, or for any SIPP investment by a retail customer who is not known to have received independent regulated advice about the investment." The FCA said to act otherwise would be to not act in the client's best interests in accordance with COBS 2.1.1R.

With regards to the s.27 Claim, the FCA supported Mr Adams' position that the activities carried out by CL&P fell within the regulated activities of arranging or advising on investments. The FCA argued that the simple "but for" test should be used for determining a causal link between the act of arranging and any subsequent transaction.

Outcome

COBS Claim

HHJ Dight rejected Mr Adams' arguments, and the submissions of the FCA, agreeing with Carey and finding that it was "obvious that the correct starting point" in ascertaining the scope of the obligations imposed by COBS, and in construing those obligations, was the contract between the parties, "because it is common ground that not every COBS obligation" applies to all firms. Further, HHJ Dight added that no "provision was drawn to my attention at trial to demonstrate that, so far as the COBS duties which I am considering are concerned, the regulatory regime is intended to take precedence over the contractual terms or, insofar as material, that the contractual relationship(s), duties and obligations between the claimant and the defendant are unenforceable." He also noted that the argument before him turned not on whether the duties could be excluded, but on what those duties were, with regard to the relevant factual context, which included the terms of the contract.

HHJ Dight found that the contractual documentation between Carey and Mr Adams showed clearly that:

- Carey was acting on an execution-only basis
- Carey was not advising Mr Adams
- The investment in Store First was high risk and/or speculative
- Mr Adams was responsible for his own investment decisions

In that context, COBS 2.1.1R could not be read as imposing on Carey a duty to advise or comment on the suitability of the SIPP or investment, as that would be unlawful, or to reject a high-risk investment. The regulatory obligations should therefore be read in light of what the contract said and any other relevant factual context. The Court found that Mr Adams had to take responsibility for his investment decisions.

HHJ Dight also rejected Mr Adams' argument that the FCA's 2009 Thematic Review document relating to SIPPs reflected a list of binding requirements that a SIPP operator had to follow. HHJ Dight found that FSMA does not include an express provision that would provide an investor with a right to bring a claim based on an alleged breach of, or non-compliance with, FCA guidance, concluding that:

> "The FCA has the power under s.139A FSMA to give guidance consisting of such information and advice as it considers appropriate concerning the operation of parts of FSMA or rules made by the FCA among other things. There is no express provision in FSMA which provides a right to an investor to make a claim based on an alleged breach of the guidance issued by the FCA from time to time. This is in direct contrast to the specific right contained in section 138D(2) to seek damages for breach of rules made by the FCA, such as the COBS Rules. The Thematic Review cannot properly be described as a set of rules or even guidance and in my judgment cannot give rise to a claim for failing to follow the suggestions which it makes. Nor in my judgment is it a proper aid to statutory construction of the COBS Rules which must be construed in accordance with the usual principles of construction."

Similarly, HHJ Dight stated that guidance issued by the FCA after the facts relevant to this claim could not have any direct bearing on the judgment.

Finally, HHJ Dight concluded that, notwithstanding the above findings, any alleged breach of COBS 2.1.1R could not be said to have caused Mr Adams' loss.

s.27 Claim

HHJ Dight disagreed with the FCA on its arguments regarding the "but for" test, and in relation to the causative link required for "arranging deals in investments", and found that "the arrangements have to be a positive or effective cause, not merely a set of circumstances which may be no more than the context in which the transaction eventuates". The s.27 Claim was dismissed because the contract in question, including an application form and terms and conditions, related to the establishment of the SIPP, and CL&P was not performing a regulated activity in relation to establishing the SIPP. It was clear that CL&P was not arranging or advising on the creation of the SIPP. It was also noted that Mr Adam's instruction to Carey to invest occurred after the SIPP had been established. Even if there had been a breach of s.27 FSMA, the Court would not have exercised its discretion to unwind the agreement, because Carey did not know that CL&P was wrongly performing a regulated activity. It was confirmed that Carey had robust processes in place to satisfy itself that CL&P was not wrongly performing a regulated activity, and was entitled to assume its system was working.

Upholding *Watersheds Ltd v. DaCosta*

HHJ Dight also dismissed Mr Adams' argument regarding the unreliability of the decision in *Watersheds Ltd v. DaCosta*,[2] a case in which the issue of whether the activities carried out by Watersheds fell under the scope of articles 25(1) and 25(2) of the RAO. Watersheds sought to assist Real Creative Group Limited (RCG) in raising finance but failed to do so. Around the same time, RCG went into administration, and Watersheds exercised its option to terminate the agreement and reclaim fees from RCG. In response, RCG claimed that the agreement with Watersheds was not enforceable because Watersheds had been carrying out a regulated activity as an authorised person.

The judge in the case was influenced by the FSA's Perimeter Guidance manual (PERG), in particular PERG 2.7.7B, which stated, "The activity of arranging (bringing about) deals in investments is aimed at arrangements that would have the direct effect that a particular transaction is concluded (that is, arrangements that bring it about)." PERG 2.7.7B also highlighted that "[t]he activity of making arrangements with a view to transactions in investments is aimed at cases where it may be said that the transaction is brought about directly by the parties. This is where this happens in a context set up by a third party specifically with a view to the conclusion by others of transactions through the use of that third party's facilities. This will catch the activities of persons such as exchanges, clearing houses and service companies". It was clear that Watersheds did not provide such services. The judgment concluded that the activity of introducing does not itself constitute a regulated activity for the purposes of article 25(2) of the RAO. The judge therefore upheld the claim by Watersheds and dismissed RCG's counter-claim that the contract was not enforceable.

The FSA argued at the time that the list of activities specified in PERG 2.7.7B was interpreted far too narrowly and not as intended, and subsequently replaced PERG 2.7.7B with a broader definition.

Historically, the FCA has not seemed able to let go of the decision in *Watersheds Ltd v. DaCosta*. The FCA brought up this argument again in *Adams v. Options SIPP UK LLP*. The FCA submitted that in construing article 25 of the RAO, the judge in *Watersheds Ltd v. DaCosta* had interpreted the word "arrangements" too narrowly, and that the judgment was decided without reference to other relevant provisions in the RAO, in particular article 33.

However, HHJ Dight disagreed with both Mr Adams and the FCA, stating that "for the arrangements to bring about the transaction there must be a direct and substantial causal connection between the arrangements and the ultimate transaction and that simply giving advice on the underlying investment and effecting an introduction are not sufficient because those acts do not necessarily result in anything further happening and the further steps which were necessary to establish a SIPP were not within the introducer's power to effect or direct." HHJ Dight saw no reason to depart from the decision in *Watersheds Ltd v. DaCosta*, reinforcing that an agreement to make an introduction does not in itself amount to "arranging"; instead, a further significant act must also take place following the introduction. HHJ Dight concluded that this was not the case in *Adams v. Options SIPP UK LLP*.

In summary, the judgment in *Adams v. Options SIPP UK LLP* helpfully reaffirms the previous position on what amounts to regulated arranging and also acts as a reminder that a firm's duties need to be construed in light of its responsibilities. How HHJ Dight's comments, in particular those in relation to the FCA's submissions, will impact the financial services industry remains to be seen.

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Endnotes

[1] *Adams v. Options SIPP UK LLP (formerly Carey Pensions UK LLP)*, [2020] EWHC 1229 (Ch).

[2] *Watersheds Ltd v. DaCosta*, [2009] EWHC 1299 (QB).