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High Court ruling in *Berkeley Burke SIPP Administration Ltd v Financial Ombudsman Service Ltd, Wayne Charlton and Financial Conduct Authority* [2018] EWHC 2878 (Admin) (30 October 2018) likely to result in steep increase in SIPP mis-selling complaints to FOS

Last week Mr Justice Jacobs decided Wayne Charlton's longstanding tussle with Berkeley Burke in his favour when he dismissed both grounds on which Berkeley Burke challenged the lawfulness of the Ombudsman's Final Decision that Berkeley Burke had not acted fairly and reasonably in its dealings with Mr Charlton and that it had to pay him compensation. The decision may yet be appealed, but Mr Charlton has the benefit of a strong judgment, decisively rejecting Berkeley Burke's arguments on both grounds on which permission for a judicial review was granted.

On the day of the judgment the FCA sent a "Dear CEO" letter to SIPP operators drawing their attention to a number of pending civil claims and Mr Justice Jacob's decision, all concerning the due diligence obligations of SIPP operators when accepting customers' investments, and confirmed that the FCA expected SIPP operators to consider the potential implications for their firms and their customers. The FCA warned that SIPP operators for whom the decision impacted their ability to meet (both now or in the future) their financial commitments as they fell due were required to notify the FCA immediately and that firms, where relevant, should also notify their professional indemnity insurers in accordance with their polices.

Industry insiders have expressed concern that this decision and possible adverse judgments for the SIPP operators in *Adams v Carey Pensions Ltd* and the class action of *Mohamed Arif and others v Berkeley Burke SIPP Administration Ltd*, might lead to "Armageddon" in the SIPP market.

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Mr Charlton's Investment

Mr Charlton's experience was fairly typical in the business framework operated by Berkeley Burke and many other SIPP operators. He was a gardener by trade and was introduced to an investment in a "green oil" scheme in Cambodia offered by Sustainable Agro Energy and promoted by an unregulated introducer. The investment concerned the acquisition of beneficial ownership in plots of land planted with jatropha trees for biofuel production. In due course Mr Charlton applied to transfer his existing personal pension (£24,000) to Berkeley Burke to invest his funds in the scheme. Berkeley Burke conducted little or no investigation into Sustainable Agro Energy or its investment offer. When making the investment into the SIPP Mr Charlton was required to sign documents that stated that Berkeley Burke had not advised on the investment, that it took no responsibility for the suitability of the investment, and that it had acted on an Execution Only Basis.

A further 616 investors invested a cumulative total of £12,250,000 (typically from their existing pension savings) into the scheme through SIPPs operated by Berkeley Burke.

Unfortunately, the investment scheme turned out to be a scam. Sustainable Agro Energy did not own title to the land, there were no trees on the land, and the terrain was unsuitable for palm oil production. Following a Serious Fraud Office investigation, the company was placed into receivership and three of its directors were jailed for fraud.

Second Ombudsman's Final Decision

Mr Charlton lost the entirety of his modest pension pot. He complained to the FOS about Berkeley Burke's conduct. The Ombudsman ruled in his favour, but when Berkeley Burke intimated that it would seek to have the decision quashed by a judicial review (on the basis that the stated reasons did not support the decision), Mr Charlton, who was not then legally represented, was persuaded by

Berkeley Burke and the FOS to agree that his complaint should be determined afresh by a second Ombudsman.

On 10 November 2016, the second Ombudsman also ruled that Berkeley Burke had failed to act fairly and reasonably in its dealings with Mr Charlton, and in his Final Decision (2 February 2017) he ordered that Berkeley Burke should pay compensation for his pension losses to Mr Charlton.

At the heart of the Ombudsman's decision was his conclusion that *Principle 2* (Skill, care and diligence:- *A firm must conduct its business with due skill , care and diligence*) and Principle 6 (Customers' interests – *A firm must pay due regard to the interests of its customers and treat them fairly*) were engaged in Mr Charlton's case, and that these principles taken together meant that Berkeley Burke was obliged to carry out due diligence into the proposed investment that went far further than ensuring that the investment was "SIPPable" under HMRC rules. Instead Berkeley Burke should have identified the investment as high risk, speculative and non-standard, and that in turn should have prompted the firm to carry out *sufficient* due diligence including *at least*:-

- Consideration whether the investment was appropriate for a pension scheme

- Ensuring that the investment was genuine and not a scam, or linked to fraudulent activity

- Independently verifying that Sustainable Agro Energy's assets were real and secure, and that the investment operated as claimed

- Ensuring that the investment could be independently valued, both a point of sale and subsequently

- Ensuring that Mr Charlton's SIPP would not become a vehicle for high risk and speculative investment that was not a secure asset and could be a scam.

The Ombudsman did not accept Berkeley Burke's submission that under COBS 11 it had had no choice but to make the investment, nor its contention that the rules permitted Berkeley Burke simply to give risk warnings and go ahead with the investment. Considering the counterfactual, the Ombudsman was satisfied that, if Berkeley Burke had acted fairly and reasonably in its dealings with Mr Charlton by carrying out adequate due diligence, it would not have accepted the scheme as a permitted investment into its SIPP.

Judicial Review Decision

Berkeley Burke brought proceedings for judicial review of the second Ombudsman's decision on two grounds. It asserted that the Ombudsman had been wrong in law to find that Berkeley Burke had not been required to execute Mr Charlton's specific instructions and in failing to follow previous decisions of the Pensions Ombudsman thereby creating an inconsistency of approach as between the FOS and the Pensions Ombudsman.

In a detailed judgment Mr Justice Jacobs systematically dismantled the four arguments advanced by Berkeley Burke under Ground 1. Ground 2 did not require the same detailed engagement: the Judge observed that the statutory scheme under which the Pension Ombudsman and the FOS operated were different, and that this was fatal to any challenge based upon the public law principle concerning consistency.

The Judge's findings in relation to the arguments advanced by Berkeley Burke under Ground 1 are of interest. By way of headline points:-

- When the Ombudsman determined a complaint, the test under s.228(2) of FSMA 2000 (*"… what is, in the opinion of the Ombudsman, fair and reasonable in all the circumstances"*) was a subjective one and for the Ombudsman alone, provided that his decision was not irrational or perverse (neither having been alleged against the Ombudsman's decision in this judicial review)

- Contrary to Berkeley Burke's submission, the Ombudsman was not creating a new rule (in relation to the due diligence that he found was necessary to act fairly and reasonably), but he was applying the wide scope of *Principles 2* and *6* to the facts before him.

- The dicta of Mr Justice Ouseley in *R (British Bankers Association) v FSA* [2011] EWHC 999 (Admin) (cited with approval by the Judge) were fatal to Berkeley Burke's attempts to put limits on the extent to which the Ombudsman was entitled to use the *Principles* in order to augment existing rules and duties. The Ombudsman had the widest discretion to decide what was fair and reasonable. This included deciding that one of two conflicting provisions was the dominant provision or that there were aspects of the *Principles* that were not adequately or fully represented in the specific rules.

- COBS 11.2.19R(1) (which, Berkeley Burke contended, obliged the firm to execute the order which they had been given) was always subject to the *Principles* because that was an overarching framework that stood over COBS 11.2.19R. The rule was concerned with the "mechanics" of execution (i.e. designed to achieve a high quality of execution) and had nothing to do with the question whether or not the order should have been accepted in the first place. There was nothing in the rule (when set in the context of Article 21 or any other provision of MiFID) that created a self-standing obligation on the firm to execute a transaction come what may. A contrary conclusion would be difficult to reconcile with the stated purpose of MiFID, namely to offer investors a high degree of protection. It followed that there was no difficulty in concluding, as the Ombudsman had done, that the *Principles* were applicable to the question whether Berkeley Burke should accept the investment in the first place, and that COBS 11.2.19R applied to the execution of the transaction once that decision was made. There was no conflict between the *Principles* and the rule, and since the rule was not immutable and did not override the

Principles, the question of the application of the *Principles* to the particular circumstances of the case was a matter for the Ombudsman. Absent a challenge on the basis of irrationality (which was not advanced) there was no error of law.

In the result the Ombudsman's decision to order Berkeley Burke to compensate Mr Charlton stands.

The decision will provide some comfort to victims of this type of SIPP mis-selling, particularly where their entire pension provision has been irretrievably lost through a fraudulent investment scheme. Transactions following this pattern will invariable predate 1 April 2019, so that the compensation limit will be the current £150,000 (adjusted for inflation to £160,000 from 1 April 2019) and not the new, higher compensation cap of £350,000 that is coming into force next year for claims relating to incidents taking place on or after 1 April 2019. Nevertheless, the lower compensation cap is perfectly adequate and apt to provide full compensation of losses for pension savers in Mr Charlton's position. The FCA had warned at several junctions in the past few years that many SIPP operators have operated under a business model that stipulated execution-only services, relied on disclaimers and appeared to avoid even rudimentary due diligence before admitting unregulated investments into their SIPPs. The FOS will brace itself for a substantial increase in SIPP mis-selling complaints against SIPP operators.

Other Legal Proceedings

The issues in *Adams v Carey Pensions Ltd* and in the Group action against Berkeley Burke are, of course, rather different. Only rule breaches (but not breaches of the *Principles*) are actionable at the suit of a private person under s.138D FSMA, and the court will be concerned with statutory and common law duties, their breach and issues of causation and remoteness of loss, in distinction to the Ombudsman's subjective assessment of whether the firm has acted fair and reasonably and of the compensation that would, in his view, constitute fair and reasonable redress.

These decisions are keenly awaited, and we will post a note discussing the results and implications when the judgements are to hand.

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7 November 2018