ADAMS v OPTIONS UK

[2021] EWCA Civ 474

BLACKBURN'S CONTRIBUTION TO FSMA

Introduction

1. This case is about storage pods in Blackburn. It is hard to see how even Lord Denning could have fashioned a lyrical opening passage for his judgment, from such prosaic beginnings[1]. However, it has the potential to have far reaching effects on financial services law.

2. This Note considers
   (i) Sections 27 and 28 and the guidance given by the Court in relation to their working.
   (ii) Useful guidance provided by the Court in relation to certain expressions used in the Regulated Activities Order 2001 (RAO: SI 2001/544).
   (iii) The Court's consideration of the concept of "braided advice": advice on regulated and unregulated matters.
   (iv) Why section 27 applied in **Adams**.
   (v) The Court's approach to the exercise, or not, of its power under section 28 FSMA, and the guidance given.

Facts

3. The facts can be shortly stated. Mr Adams was an unsophisticated investor. He was a lorry driver. He had built up a pension fund with Friends Life, valued at £52,000 odd.

4. But in early 2012, he needed money to pay off a judgment obtained against him by HSBC. He saw an advertisement promising a means of releasing cash from his pension. He answered the advertisement and was put in touch with an entity called CLP. CLP operated from Spain. CLP was not regulated by the FCA.

5. CLP recommended a "store pod" investment to Mr Adams.

6. CLP introduced Mr Adams to the Defendant SIPP operator. Establishing a SIPP enabled Mr Adams to cash in his Friends Life pension, place the money into the SIPP, and make the store pod investment. CLP paid Mr Adams £4,000 as an incentive.

7. The Defendant provided Mr Adams with extensive documentation. That documentation (as is and was common practice) made it clear that the Defendant was not providing any advice on the merits of investments held within the SIPP, and that Mr Adams ought to obtain independent financial advice on that matter. Mr Adams candidly accepted at trial that he knew that the store pod investment was risky and that he had wanted a risky investment (given that it might have generated high returns).

8. The store pod investment failed, and Mr Adams lost most of the money.

[1] I was tempted to misquote the Beatles' "Day in the Life": but it is not clear to me that there were four thousand holes in Blackburn, Lancashire. The pods seem to have been fewer in number, and above the surface.

9. The investment was made in July 2012. Before that time, in May 2012, the Defendant had terminated its relationship with CLP because it had become aware that incentive payments were being made. However, Mr Adams' case was by that time "in the pipeline" (the SIPP had been established and a request for the transfer had been made to Friends Life). Pipeline cases were proceeded with by the Defendant.

The Claim

10. Mr Adams advanced 3 claims:

    (i) A claim under section 27 FSMA;
    (ii) A claim for damages for breach of COBs; and
    (iii) A claim that the Defendant was a joint tortfeasor with CLP and therefore shared responsibility for CLP's negligence.

11. The joint tortfeasor claim failed at trial and was not renewed on appeal.

Disposition of the Appeal

12. Mr Adams' claim under section 27 succeeded but the appeal on the COBS point was dismissed. The COBS claim failed because, as presented on the appeal, it differed so much from the pleaded claim and the claim advanced at trial as to amount to a new claim. The Court of Appeal was not prepared to entertain that new claim. Accordingly, the appeal has not provided the guidance, which was anticipated as to the effect of COBS, especially in a situation where the SIPP provider (as here) has taken great care to draft its documentation so as to emphasise that it is not providing advice on the merits of the underlying investment.

Sections 26, 27 & 28 FSMA

13. It is essential to understand the relevant sections of FSMA.

14. These sections are, broadly speaking, concerned with agreements made in breach of the general prohibition, whereby a person who is not authorised by the FCA or exempt from such authorisation[2] carries on a "regulated activity" in the UK: see section 19 of FSMA. Breach of the general prohibition is a criminal offence: section 23.

15. Section 26 concerns the simple case where the Defendant (D) makes an agreement with the investor (I), but D is in breach of the general prohibition because the making of that agreement involves D in carrying on regulated activity when D is not authorised or exempt. In that situation, the agreement is unenforceable against I, and I is entitled to recover (a) money paid or property transferred under the agreement and (b) compensation for any other loss as a result of parting with the money or property.

16. Section 27 concerns a tri-partite situation. Here again, D enters into an agreement with I, but D does not thereby breach the general prohibition because D is authorised or exempt. However, the agreement is made "in consequence of something said or done" by a third party (T); and T's statement or action was carried out in breach of the general prohibition.[3]

[2] For example, because he or she is an appointed representative of an authorised person: see section 39.
[3] D, I and T are used in the same sense in the remainder of this Note.

17. Where section 27 applies, again, the agreement is unenforceable. I can recover money or property paid and compensation for consequential loss.

18. Both sections are subject to section 28. Section 28(3) permits the Court to declare the agreement enforceable or to permit D to retain money or property transferred in consequence of it, if the Court is satisfied that it is just and equitable to do so.

19. The Court is directed in particular to look at the following issues when asked to exercise its discretion:

    (i) In a section 26 case, whether D reasonably believed that he was not acting in contravention of the general prohibition; and
    (ii) In a section 27 case, whether D knew that T was acting in contravention of the general prohibition.

20. As will be seen, the Court of Appeal found that D was liable under section 27 and was not able to obtain relief under section 28.

The Regulated Activities Order (RAO)

21. Before turning to the Court's reasoning, we must note certain provisions of the RAO. The RAO is of course the SI which sets out what activities are regulated ones, and therefore is integral to the working of sections 26, 27 and 28 of FSMA.

22. There is, unfortunately, no substitute for laboriously working through the RAO, in any given case, in order to see how it applies: but the **Adams** judgment does give useful guidance on some of the commonly encountered articles. The discussion which follows does not give an account of every nuance of the articles considered (since to do so would make the discussion interminable). Instead, its purpose is to set the context for some of the Court's more interesting observations on what some of the general concepts mean.

23. By Art.25 of the RAO, it is a regulated activity for D to "make arrangements" for I to "buy sell subscribe for or underwrite" a particular investment, if that investment is (inter alia) a security or a relevant investment.

24. This general rule is hedged about with specific exclusions: see, e.g.:
    (i) Art.26 (arrangements excluded if they do not "bring about" the relevant transaction;
    (ii) Art.27 (providing the means whereby I can communicate with T is not in itself within Art.25); and
    (iii) Art.33 (in summary, where D introduces I to T, so that T may advise I, and T is an authorised or exempt person).

25. Also relevant is Art.53, which provides that "advising on investments" is a regulated activity. This is so if the advice is given to I in his capacity as an investor, and is "advice on the merits" of I's "buying selling subscribing for or underwriting" a "security or relevant investment".

Art.25: (1): What is the relevance of a change in the underlying investment held within a SIPP?

26. This issue arose because it was common ground that the store pods themselves were not a "security" or a "relevant investment": §54. However, Mr Adams, supported by the FCA, argued that the purchase of the store pods was, nonetheless, a "relevant transaction". This argument pointed out that Arts. 25 and 53 of the RAO related to selling, and advising on the sale of, a security. Selling includes "disposing [of the asset] for valuable consideration" and "disposing" includes converting an investment which consists of rights under a contract.

27. The Court rejected these arguments. It held that Mr Adams' rights under the SIPP were rights under the trusts created by the SIPP arrangement and not contractual rights: §62, 64.

28. It also held that an alteration in the underlying investments was not a conversion, disposal or sale of those rights. The change in the underlying investments may alter the value of the rights of participation in the SIPP: but it does not alter the character of those rights. Thus, exchanging or altering the underlying assets in the SIPP, or advising about that matter, is not a regulated activity.

29. It is submitted that this is clearly correct. Note that this decision means that the Perimeter Guidance (at PERG 12.3) is wrong: §66. It is assumed that the FCA will amend this guidance in early course.

Art.25: (2): Causation and "Bringing about"

30. This is a critical concept for the purposes of Art.25 since, if it is not satisfied, the "arrangements" do not bring about the deal, and Art.26 therefore exempts them from the wide regulated "net" cast by Art.25.

31. At first instance, Mr Adams submitted that this was a straightforward "but for" test of causation.

32. The Judge rejected that submission, and the argument in the Court of Appeal was more nuanced. The Court of Appeal accepted that a "but for" test could not have been intended, since that test would catch too much (e.g., the initial advertisement which Mr Adams saw). Equally, problems could be caused where there were several people without whose actions the transaction would not have occurred: in those circumstances it might be difficult to establish that a "but for" test was satisfied even in relation to a party whose activities had a major influence on matters. See §94.

33. The Court of Appeal held that arrangements "brought about" a transaction if they were causatively potent. They had to play a role of significance: but it was not necessary to satisfy a "but for" test, nor need it be shown that the arrangements "must necessarily result" in the transaction (§95, 97).

Art.53: Advice on the merits: What is "advice"?

34. This phrase can cause difficulty, because communications between D and I are frequently capable of being characterised as either (i) the provision of information but not the provision of advice or (ii) the provision of advice which happens also to consist in passing on information. Unauthorised or unscrupulous parties will often deny that there is a true advisory element to their activity.

35. Equally, of course, the issue is important because, commonly, enquiries are made and answered about matters which are purely factual: e.g., "what corporate bonds are currently yielding X%"

or "does this product involve a full or limited recourse loan". It would be unfortunate if answering such factual enquiries might court the danger of giving advice.

36. The Court of Appeal approved previous dicta in **Walker v Inter-Alliance Group** [2007] EWHC 1858 (Ch), Henderson J, and **Rubenstein v HSBC** [2012] PNLR 7[4]. It held as follows (§75):

"It is plainly the case that the simple giving of information without any comment would not normally amount to "advice". On the other hand… the provision of information which is itself the product of a process of selection involving a value judgment so that the information will tend to influence the decision of the recipient is capable of constituting "advice"… [A]ny element of comparison or evaluation or persuasion is likely to cross the dividing line."

37. It is submitted that this is clearly correct. What looks like "information" can frequently influence the mind of the recipient because of the manner in which it is presented. Equally, if the provider of information makes a value judgment as to what information he will supply, he is or should be exercising professional skill in so doing. He may therefore fairly be said to be advising.

38. The Court also pointed out that advice is often accompanied by information supporting or explaining the advice: but this need not be so. It was held (§75) that "a communication to the effect that the recipient ought say to buy a specific investment can amount to advice on the merits [even if given] without elaboration on the features or advantages" of the investment.

39. Finally, the Court made the point that the advice need not relate to a single specified investment. Advice to buy shares in a company remains advice, even though the client might be able to choose from different classes of shares. But advice might be too generic to be advice on a particular investment: e.g., advice to invest in "European equities" is too broad. See §76.

"Braided" Advice

40. Difficulties frequently arise in practice where an adviser, D, advises on different elements of a situation which cover both regulated and unregulated products. For example, D advises I to withdraw funds from a regulated investment (which would fall within Art.25 RAO because of the reference to advice about "selling" an investment). D then advises I to invest the proceeds in an unregulated scam. The loss arises from the second element of the transaction: the scam product. Is the advice regulated or not?

41. In **R (Tenetconnect) v FOS** [2018] 1 BCLC 726, Ouseley J had to deal with precisely that problem. He coined the useful phrase "braided advice" to refer to a situation where in practical terms the advice was a single indivisible piece of advice (sell X and invest the proceeds in Y) and that in such circumstances, where X was a regulated and Y an unregulated product, the whole of the advice would be regulated. It would not matter that the loss arose from the unregulated transaction.

42. Whilst the degree to which the advice is truly "braided" is no doubt fact sensitive, depending on the chronology and the terms of the advice, the principle advanced in that case was approved by the Court of Appeal. See e.g., at §67, 68 & 134. At §134, Andrews LJ cautioned against "compartmentalising" elements of the advice, preferring a "holistic assessment" undertaken in

[4] Reversed on other grounds: [2013] PNLR 9, without doubting the relevant passage.

a "realistic and common-sense manner". This strongly suggests that in most cases containing the fact pattern explained in paragraph 41 above, the advice will be viewed as a whole and held to be regulated advice.

Section 27: why it applied in Adams

43. The Court concluded (reversing the Judge) that CLP had given "braided" advice. It had advised on the acquisition of the store pods (an unregulated piece of advice), but it had also advised on the transfer of funds out of the Friends Life pension and into the SIPP. The only purpose of these latter elements of the advice had been to enable the store pod investment to be made.
44. Thus, CLP had advised on investments without being authorised to do so, thereby carrying on a regulated activity within the meaning of RAO Art.53, and in breach of the general prohibition. See §82.

45. Further, CLP had made arrangements which brought about the surrender of the Friends Life pension and the placing of the proceeds in the SIPP. It thereby carried on a further regulated activity, within Art.25 of the RAO, and thus breached the general prohibition in this respect, too.

46. CLP had assisted with the completion of the application form, assisted with money laundering checks, and procured a letter of authority from Mr Adams permitting the Defendant and CLP to liaise. These matters were found to be "significantly instrumental in the material transfers" and so Art.26 was engaged. See §98-100.

47. These contraventions of the general prohibition had the consequence that Mr Adams contracted with the Defendant to set up the SIPP, and so section 27 applied (see §103-105). Thus, the Defendant was liable unless it could obtain relief under section 28.

Just and Equitable & Section 28

48. The first important point to note is that the Court identified a difference in the specific "issues" which the section says are relevant to the exercise of the discretionary power.

49. Section 28(5) refers to the bi-partite situation, covered by section 26. It says that the issue is whether D "reasonably believed" that he was not contravening the general prohibition. Naturally therefore there are 2 requirements. First D must satisfy the Court that he so believed, and secondly, he must show that his belief was reasonable.

50. Section 28(6) refers to the tri-partite situation, covered by section 27. This sub-section asks whether D knew that T was contravening the general prohibition. Thus, this issue does not encompass the question whether D ought reasonably to have known or suspected that such was the case. See §109.

51. The Court also commented (§ 110) that if it is being suggested that D knew this, such a suggestion ought specifically to be put in cross examination. With respect, it is hard to see how an argument mounted on actual knowledge of criminal behaviour could be fairly mounted without this suggestion being expressly put. The Court is clearly right about this.

52. The resolution of the "specific issue" is not determinative: so, if D had the knowledge referred to in section 28(6) or lacked the reasonable belief referred to in section 28(5), it is not

necessarily doomed: but it will have an uphill task. Equally, if the specific issues are resolved in D's favour, relief does not necessarily follow. See §111.

53. It is submitted that this analysis is clearly correct.

54. What is more controversial is the approach of the Court to the exercise of the discretion. The Court was clearly of the view that the section ought to operate with the purpose of consumer protection in mind. It is submitted that on the facts, this amounts to saving Mr Adams from the consequences of his own folly. This is not obviously consistent with section 1C(2)(d) FSMA (principle that consumers should take responsibility for their own decisions) or the comments of Lord Sumption in **FCA v Asset Land** [2017] Bus LR 524 (see §88 thereof) to the effect that FSMA is to be construed so as to achieve a balance of interests, not to protect every victim of an unscrupulous operator from the loss he sustains.

55. Further, the Court suggested that the question of what the Defendant ought reasonably to have known about CLP breaching the general prohibition was a relevant factor (§ 111). It is respectfully suggested that this is a dubious conclusion: if constructive knowledge were relevant in relation to an issue which section 28 identifies as key, one might expect the section to be worded appropriately.

56. The points were fairly made, it is submitted, that the Defendant was not personally at fault, had devised and operated proper controls, and had been misled by Mr Adams' false declaration that he had received no incentive payment.

57. However, on the facts here, there were 2 important points against the Defendant: first, the large volume of business it had been doing in the store pods, which perhaps indicated that its due diligence ought to have been increased/more stringent, and second, the fact that Mr Adams' pipeline case was permitted to proceed even after the Defendant had discovered the misconduct of CLP.

58. It may be that the answer to the tension between this case and **Asset Land**, in terms of whether consumer protection ought to be the trump card, lies in the fact that sections 26 and 27 deal with specific instances where the consumer becomes involved in a transaction which involves a breach of the general prohibition. As the Court said at §115(ii), "while SIPP providers were not barred from accepting introductions from unregulated sources, section 27… was designed to throw risks associated with so doing onto the providers". See also per Andrews LJ at §131.

59. If the remarks of the Court of Appeal about consumer protection are understood in that context and bearing in mind that section 27 is only relevant where the third party is acting in breach of the general prohibition, the overall result of this part of the appeal can be justified. It is a case in which a specific section of FSMA is, as the Court noted, constructed so as to place risk on the provider. If the provider chooses to deal with an unregulated introducer it does so at its own risk. It is submitted that it would be unfortunate, and inconsistent with **Asset Land**, if the Court's remarks were taken out of context and used to support a more general conclusion that FSMA ought always to be purposively construed in favour of the consumer.

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