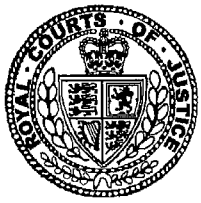

Neutral Citation Number: [2014] EWHC 3630 (Ch)

Case No: 08C03304

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION

The Rolls Building
7 Rolls Buildings, Fetter Lane, London, EC4A 1NL

Date: 05/11/2014

Before :

MR D HALPERN QC (SITTING AS A DEPUTY JUDGE OF THE CHANCERY DIVISION)

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IN THE MATTER OF THE FINANCIAL SERVICES AND MARKETS ACT 2000
Between :

THE FINANCIAL CONDUCT AUTHORITY	**Claimant**
- and -	
(1) JOHN CECIL ANDERSON	**Defendants**
(2) KENNETH ALAN PEACOCK	
(3) KAUTILYA NANDAN PRUTHI	
-and-	
PETER LLOYD	**Interested Party**

- - - - - - - - - - - - - - - - - - - -
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Mr James Purchas (instructed by on a direct access basis) for the **Claimant**
Mr Daniel Bayfield (instructed by **Berwin Leighton Paisner LLP**) for the **Trustee in Bankruptcy of the Defendants**
Mr Peter Lloyd in person

Hearing date: **28th October 2014**

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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MR D HALPERN QC (SITTING AS A DEPUTY JUDGE OF THE CHANCERY DIVISION)

Mr D Halpern QC :

1. This is an application by the Financial Conduct Authority ("FCA") under section 382 of the Financial Services and Markets Act 2000 ("the Act") for directions relating to the distribution of sums to depositors. It appears that there is very little judicial guidance as to the basis on which the court should give such directions. It also appears that this is the first case in which directions have been sought for a tiered Ponzi scheme. In the present case there were 3 Ponzi schemes, one operated by each of the Defendants, but those operated by Mr Anderson and Mr Peacock were in effect sub-schemes of the scheme operated by Mr Pruthi.

2. On 25th March 2010 Lewison J gave summary judgment in the current proceedings ([2010] EWHC 599(Ch)) in which he concluded that the Defendants had been carrying on a regulated activity by accepting deposits without being authorised or exempt. On 29th June 2010 Vos J gave a judgment in the current proceedings ([2010] EWHC 1547 (Ch)) in which he assessed the just sum which each Defendant should pay by way of restitution under section 382(2) of the Act. He envisaged that the Financial Services Authority (now the FCA) would subsequently apply for directions as to the distribution of such sums to qualifying persons. It is this application which I must now determine.

3. I have heard, and been much assisted by, submissions from Mr James Purchas (for the FCA), Mr Daniel Bayfield (for the Trustee in Bankruptcy of all 3 Defendants), and Mr Peter Lloyd, who appears in person as an Interested Party. Mr Bayfield readily accepts that his client has a potential conflict of duties in being the trustee in all 3 bankruptcies and that this may need to be resolved in due course, but he took a neutral stance at this hearing.

4. Mr Lloyd told me that he has written authority to speak for 318 of the depositors, although (as far as I am aware) there is no formal order for representation. He readily accepted that the depositors have potentially conflicting interests. Ideally, if there were enough money, it would be desirable to have separate representation for each group of depositors. However, the unfortunate reality is that, whilst the just sums ordered by Vos J to be paid by Anderson, Peacock and Pruthi respectively amount to more than £13m, more than £11m and more than £90m (translated into Sterling), the amounts which the Trustee in Bankruptcy may pay are currently estimated to be £10,659, £122 and £879,990 respectively (and even these comparatively modest sums might be reduced if there are other claims in the bankruptcies). There is currently no agreement between Mr Lloyd and the FCA as to the amount of actual losses. Mr Lloyd believes that they amount to some £13m, whilst I am told that the FCA's figure is about £46m. Nevertheless, whatever the right figure, there will be a very substantial shortfall in recoveries. This inevitably means that the court has to do the best it can on a rough-and-ready basis and that it would be not proportionate to have separate representation for each class of depositor which has a divergent interest.

5. There is a further factor which makes it inevitable that justice can be no more than rough-and-ready in this case, and that is that the facts have never been fully agreed or determined. In paragraph 21 of his judgment Lewison J explained that there were 3 different schemes, all of which involved relatively short-term contracts. It appears (as is often the case with Ponzi schemes) that those who invested in the early years were more likely to gain a benefit by way of interest payments than those involved in the later years, who were likely to lose their capital. No doubt there are some depositors who are in both classes. The FCA has not been able to determine in respect of each depositor when he first deposited money, how much interest he earned, and whether he recovered his capital and reinvested it.

6. Mr Lloyd presented his arguments to me in a fair and moderate way, doing the best he could to reflect the divergent interests which he represents. There is clearly considerable anger and a sense of frustration on the part of the depositors, which includes criticisms of the FCA. However, I explained to him that this hearing is not concerned with a determination of the FCA's conduct and I make no finding on that issue.

7. Section 382(3) of the Act simply states that:

> "Any amount paid to the Authority in pursuance of an order under subsection (2) must be paid by it to such qualifying person or distributed by it among such qualifying persons as the court may direct."

8. The section gives no guidance as to how the discretion is to be exercised. I was told by Mr Purchas that, as far as the FCA is aware, there is no case which gives guidance on the general approach to be adopted. However, he told me the FCA has previously submitted, and the court has previously accepted, that it should have regard to the following non-exhaustive list:

   8.1 The underlying purpose of the payment to the FCA and the statutory objective for the payment under section 382(1) and (2);

   8.2 Whether the members of the proposed distribution class meet the statutory requirements; and

   8.3 That the distribution among the class is fair.

9. As regards (a), I remind myself that the purpose of the payment is to require the Defendants to disgorge profits and/or to compensate for losses. In the present case I am concerned only with the latter. I bear in mind the considerations which weighed with Mr Jules Sher QC sitting as a deputy judge of the Chancery Division in *FSA v. Shepherd*, which are quoted by Vos J and summarised by him at paragraph 74 of his judgment.

10. As regards (b), "qualifying person" is defined in section 382(8) as being a person appearing to the court to be someone (a) to whom a profit has accrued as a result of the contravention or (b) who has suffered a loss as a result of the contravention. In other words, the court has jurisdiction to extend the class, not just to depositors who have suffered a real loss, in the sense of being out of pocket, but also to those who did not receive the profit which they were expecting. Mr Purchas submitted, and I accept, that where there is an enormous shortfall between the actual losses and the amount

recoverable, out-of-pocket losses are much more deserving of compensation than expectation losses. I therefore have no hesitation in limiting the class of person to those within section 328(8)(b). Mr Lloyd, to his credit, accepted this proposition, even though it is contrary to his own financial interests.

11. The FCA has prepared schedules identifying 591 depositors who have lost money on the scheme. These schedules were put before Vos J and were agreed by the Defendants, subject to amendments which the FCA accepted. Although the amended schedules were not formally approved by Vos J, they formed the basis of his calculation of the just sums. In the circumstances I accept that everyone in the amended schedules is a qualifying person. Mr Purchas told me that 452 of these depositors have subsequently made contact either with the FCA or (in the case of some 55 depositors) with Mr Lloyd; the remaining 139 have not yet made contact. On 22nd May 2014 Proudman J directed that the FCA should take further steps to publicise its proposed distribution; this was duly done. I am satisfied that sufficient steps have now been taken to bring the existence of the proposed distribution to the attention of potential depositors and that no further step need be taken.

12. I propose to include a general liberty to apply, which will provide a mechanism for anyone who has not yet claimed to do so. I say nothing to encourage any further applications. Without seeking to bind any judge who hears such application (if any be made), I would expect that the application would be dismissed unless cogent reasons were put forward for the delay in applying. In any event, it will be too late once the money has been distributed. There has to be some finality in this matter and in my judgment the FCA should not delay making distributions because of the remote possibility that more depositors might emerge in the future.

13. I now turn to the question of fairness, which formed the principal focus of the hearing before me. One of the most striking features of this case is the enormous gap between the losses suffered by depositors and the sums available for distribution. This makes it imperative that any method of distribution is as simple as is possible, consistent with it being fair in a rough-and-ready way. There is a real risk that any attempt to achieve perfect justice would itself become a source of unfairness, firstly because it is likely to involve spending disproportionate costs in attempting to fine-tune the scheme, secondly because it is impossible to understand fully the divergent interests of each class of depositors when they are not separately represented, and thirdly because a complex scheme is likely to be disproportionately expensive to administer.

14. If one leaves aside the actual facts in this case, I would expect a perfect scheme to have the following features:

    14.1 Each depositor should be able to claim his capital losses, i.e. the amount of capital which he invested and has not recovered.

    14.2 Arguably each depositor should be able to claim interest on the capital lost. I am not referring to interest at the contractual rate, since I have already said that, where there is a shortfall, out-of-pocket losses are usually more deserving of compensation than expectation losses. Instead I am referring to interest as compensation for the time-value of money. A depositor who loses £100 in 2000 suffers a greater loss than one who loses £100 in 2010. However, I have described this as being arguable, because there is a contrary argument that capital losses should be compensated in full before any interest is awarded.

14.3 Each depositor should give credit for interest actually received, since this reduces his overall loss.

14.4 If the total available for distribution is less than the amount to which each depositor is entitled, the claims should be scaled down pro rata.

14.5 If any depositors fail to claim, their sums should be divided between those who have claimed, provided that recoveries do not exceed 100%.

15. However, the Ponzi schemes operated in the present case make it impossible, or at least disproportionately difficult, to give effect to such an arrangement for the following reasons:

15.1 The contracts within the schemes were all relatively short-term. Many depositors rolled their money over from one contract into another and it is difficult to say precisely when each one suffered the relevant loss. For example, in an email forwarded to me after the hearing, Mr Lloyd explains that he made his initial investment in September 2005. I assume that this was repaid with interest. He then reinvested in early 2006 and this was rolled over continuously until November 2008, when the FSA intervened.

15.2 As is often the way with Ponzi schemes, those who invested at the outset sometimes made a profit, at least in the early years, but it is difficult to quantify that profit. This is a reason for not compensating them for the time-value of money.

15.3 Mr Mangioni of the FCA explains in his third witness statement that it has been possible to reconstruct some 70% of the interest actually received by depositors in the Pruthi schemes, but not 100%. Mr Lloyd rightly points out that this might possibly result in some over- or under-compensation. However, I agree with Mr Purchas that, whilst that is regrettable, there is no way of avoiding it unless one takes a starting point at a later date. In my judgment that would itself lead to further unfairness, since there is no logical reason for choosing a later date.

15.4 The overall sum payable by each Trustee in Bankruptcy will depend on what other claims are made in the bankruptcies. It is therefore necessary to refer in the scheme to percentages rather than fixed sums.

16. In the circumstances, the FCA proposes that the starting point should be to allow each depositor to claim the capital sum recorded at the time of the FCA's intervention less interest paid in respect of that and previous contracts. This will not take account of depositors who withdrew their money with interest and then re-invested it. I accept that this is not a perfect solution, but I consider that the attempt to achieve a more perfect solution is likely to result in disproportionate expense without necessarily achieving a better result.

17. The FCA proposes that the amount paid by the Trustee in Bankruptcy of each Defendant be allocated to the depositors of the relevant Defendant's Ponzi scheme. Mr Lloyd proposes, by contrast, that the sums should be pooled and divided pro rata between all the depositors. Mr Bayfield took a neutral position on this point but helpfully referred me by way of analogy to *Re BCCI (No 3)* [1993] BCLC 106 at 111 (upheld on appeal at [1993] BCLC 1490), where Nicholls V-C approved an arrangement to pool the assets of two

BCCI companies in liquidation on the basis that their affairs were so hopelessly intertwined that this was the only sensible way to proceed. Nicholls V-C acknowledged that this was an exceptional measure but explained that he took this course because it would make no sense to spend vast sums of money and much time in trying to disentangle and unravel the transactions. In the present case I have an unfettered discretion but I take as my starting point that I should respect the separate existence of each of the three schemes unless fairness requires that they be pooled. The strongest argument in favour of pooling is that the schemes run by Anderson and Peacock were sub-Ponzi schemes which fed into Pruthi's scheme. However, as against that, each Defendant offered his personal guarantee to depositors in his scheme. On balance, it strikes me as fairer to apply each Defendant's payment to his depositors in recognition of that guarantee. There is no practical difficulty of the kind referred to by Nicholls V-C if the separate identity of each scheme is maintained.

18. Anderson and Peacock have substantial claims as depositors in Pruthi's bankruptcy. I am told that the result will be that Pruthi's depositors will recover a lower percentage than those of the other Defendants. According to the FCA's current calculations, Pruthi's depositors will recover 2.49% whilst Anderson's and Peacock's will recover 2.75% and 3.19% respectively. Given the unfortunate fact that all recoveries will be very modest in overall terms, I consider that it would be disproportionate to attempt to fine-tune the order to take account of this.

19. Needless to say, I have formulated a scheme on the assumption that there is no duplication. I cannot prevent any future applications from being made by the Trustee in Bankruptcy of one Defendant against another and it was agreed at the hearing that there was no way of pre-empting this by altering the draft scheme at this stage. All I can do is to give liberty to apply, so that the court may adjust the proposed scheme if it subsequently appears unfair in the light of changed circumstances.

20. By the same token, nothing can be done to prevent depositors from making their own independent claims in the relevant bankruptcy under section 29 of the Act. Once again, I have formulated the scheme on the assumption of no duplication, but have included liberty to apply in case a claim is successfully made in the bankruptcy.

21. Mr Lloyd suggests that there are errors in the FCA's calculations. If he maintains this suggestion, he (or any depositor claiming that there are errors) may write to the FCA. If the matter is not resolved by agreement, Mr Lloyd or anyone affected may apply to court under the liberty to apply.

22. Although I will give an unrestricted liberty to apply, the court will expect anyone invoking that procedure to have regard to the principle of proportionality and not to make an application unless the desired outcome is likely to justify the costs.

23. I have dealt with the main points of principle in this judgment, but there are additional smaller points which will be apparent from the form of the Order. I will hear the parties before finalising the Order.