



Neutral Citation Number: [2013] EWHC 1655 (Ch)

Case No: 9527 of 2011

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT

Royal Courts of Justice
Rolls Buildings
Fetter Lane
London, EC4A 1NL

Date: 14/06/2013

Before :

MR JUSTICE DAVID RICHARDS

IN THE MATTER OF MF GLOBAL UK LIMITED (in special administration)

AND IN THE MATTER OF THE INVESTMENT BANK SPECIAL
ADMINISTRATION REGULATIONS 2011

**(1) MF GLOBAL UK LIMITED (in special
administration)**

(as Trustees of the Client Money Trust)

(2) RICHARD HEIS

(3) MICHAEL ROBERT PINK

(4) RICHARD DIXON FLEMING

(as Administrators of the above named Company)

Applicants

Antony Zacaroli QC and Adam Al-Attar (instructed by Weil, Gotshal & Manges)
for the Applicants

Hearing dates: 10-11 June 2013

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.

MR JUSTICE DAVID RICHARDS

Mr Justice David Richards :

1. This is an application by the Administrators of MF Global UK Limited (MFG UK) and by MFG UK in its capacity as trustee of a client money trust established by rules made by the Financial Services Authority (now the Financial Conduct Authority) pursuant to statute, for directions as regards the administration of the trust and the distribution of its assets.
2. As an investment bank authorised to carry on business by the FSA, MFG UK was required to hold client money on the terms of this trust.
3. MFG UK was part of a group of companies carrying on business as broker-dealers in financial markets throughout the world. The group's principal operations were in New York and London, carried on by MF Global Inc and MFG UK respectively. These and other companies entered formal insolvency proceedings in the United States and England on 31 October 2011. The administrators of MFG UK were appointed under the Investment Bank Special Administration Regulations 2011.
4. The FSA was empowered by section 139 (1) of the Financial Services and Markets Act 2000 to make rules providing for clients' money to be held on trust in accordance with the rules. The relevant rules are contained in chapters 7 and 7A (CASS 7 and 7A) of the Client Assets Sourcebook section of the Financial Services Authority Handbook. These rules are intended to implement in the UK the requirements of the Market Financial Instruments Directive 2004/39/EC and the Commission Directive 2006/73/EC, the overall purpose of which is to provide a high level of protection to clients.
5. Client money must be segregated from an investment firm's own money by being paid into and held in "an account or accounts identified separately from any accounts used to hold money belonging to the firm" (CASS 7.4.11R). The trust of client money is created by CASS 7.7.2R which provides, so far as relevant, that:

"A firm receives and holds client money as trustee (or in Scotland as agent) on the following terms:

(1) for the purposes of and on the terms of the client money rules and the client money distribution rules;

(2) subject to (4) for the clients for whom that money is held, according to their respective interests in it;

(3)

(4) on failure of the firm, for the payment of the costs properly attributable to the distribution of the client money in accordance with (2); and

(5) after all valid claims and costs under (2) and (4) have been met, for the firm itself."

CASS 7.6 requires a firm to keep records and accounts so as to enable it to distinguish client money held for one client from client money held for any other client and from its own money.

6. CASS 7A contains the client money distribution rules, applicable on the occurrence of “primary pooling event”, which includes the appointment of administrators or other insolvency proceedings in respect of the firm. In that event, client money held in each client money account of the firm is treated as pooled and it must be distributed by the firm in accordance with CASS 7.7.2R “so that each client receives a sum which is rateable to the client money entitlement calculated in accordance with CASS 7A.5R” (CASS 7A.2.4R). It is unnecessary to refer in detail to CASS 7A.2.5R which makes provision for set-off.
7. The overall purpose of CASS 7A is, as explained in CASS 7.A.1.2G, to ensure the timely return of client money to clients following a primary pooling event.
8. By these rules, a trust is created, with identifiable trust property and, following the majority decision of the Supreme Court in *Lehman Brothers International (Europe) v CRC Credit Fund Ltd* [2012] Bus LR 667, identifiable beneficial interests. There are however no provisions setting out a procedure whereby claims to client money can be made and adjudicated or a process whereby client money can be distributed among those entitled to it. There is nothing, for example, equivalent to the procedure in the Insolvency Rules for the submission, adjudication of claims, and distribution in respect of proofs of debt, where distributions can safely be made on the basis of proofs submitted prior to a specific date, with late-comers being prevented from disturbing prior distributions. Nor is there anything equivalent to the bar date mechanism under the Special Administration Rules relating to the distribution of assets of investment banks. The absence of such provisions is surprising, given that an investment bank is likely to have dealt with a large number of clients who may, but equally may not, have valid claims to share in the distribution of client money. In many cases, they will have alternative or additional claims as unsecured creditors of the investment bank.
9. In dealing with the client money trust, the administrators of MFG UK face precisely the types of problems which liquidators and administrators habitually face when dealing with the claims of a large number of unsecured creditors. In particular, there are claims which have been submitted but rejected in whole or in part. Moreover, there may be potential claimants with good claims who are unknown to the administrators, because their claims are not disclosed by the records kept by MFG UK and they have not submitted claims.
10. The evidence filed in support of this application on behalf of the administrators gives a clear picture of the extent of the task and the difficulties faced by the administrators. Following a review of MFG UK’s records, the administrators have issued statements to clients reflecting what they believe to be each client’s entitlement to share in a distribution of the client money trust. Statements have been sent to a total of 4,637 clients, representing 99.8% of known claimants. Statements have not been sent to clients whose accounts had been closed prior to the administration or which show a nil balance. If a statement is accepted by a client, the procedure adopted by the administrators has been to invite the client to enter into a pro-forma settlement agreement. In addition, the administrators have received client money claims from

claimants who did not appear, by reference to MFG UK's records, to have a claim. Following consideration of these claims and any supporting evidence, they may either be agreed and a client money settlement agreement signed or they may be withdrawn or disputed.

11. The total number of client money claims so far made is 5,345, with a total value of a little over US\$2.223 billion. Of these, 3,275 claims with a total value of over US\$895 million have been fully agreed. There are 268 claims with a total value of over US\$278 million which have been rejected by the administrators, where the claimant disputes the administrators' decision. There are 1,364 claims, with a total value of over US\$62 million, where a client money settlement agreement has been sent but has not yet been agreed or has been disputed. There are 350 claims, with a total value of US\$49.35 million, from claimants who do not appear from MFG UK's record to have any client money entitlement or any claim against the general estate but which have not yet been formally rejected pending the completion of investigations. There is also a very substantial claim from MF Global Inc which has in principle been settled on the terms of a settlement agreement which will become effective on the satisfaction of a number of conditions.
12. The total funds anticipated to be available for distribution as client money is estimated to be between US\$945 million and US\$951 million. The administrators have felt able to make an interim distribution of a little under US\$214 million, representing approximately 26% of agreed claims.
13. In order to proceed with a distribution of the balance of the available funds, and to ensure the timely return of client money which is stated to be the purpose of the client money distribution rules, MFG UK and the administrators need a process to deal with rejected claims and unknown claims which can provide a degree of certainty and protection. Unless some procedure is put in place, the administrators will have to provide in full for all claims which have been rejected before any further distribution can be made and will have to issue proceedings, making all the relevant claimants respondents, in order to determine the existence and extent of their individual claims. Whether or not the claimant participates in such proceedings, the administrators will have to put before the court all evidence relevant to the individual claims. These would not be proceedings in which it would be possible for the administrators to obtain judgment in default. Even this lengthy and expensive process would not solve the problem posed by the possible existence of unknown claims.
14. The need for some means of dealing with problems of this kind has previously been recognised. The administrators of Lehman Brothers International (Europe) sought to deal with them by proposing a scheme of arrangement with client money claimants under Part 26 of the Companies Act 2006. The Court of Appeal, affirming Blackburne J, held that Part 26 did not make provision for a scheme of arrangement with proprietary claimants: see *Re Lehman Brothers International (Europe)* [2010] 1 BCLC 496. Recognising the problems faced by administrators in dealing with client asset claims, Lord Neuberger said at [86];

"I hope, indeed I would expect, that, if the administrators decide to make an application under the Trustee Acts or pursuant to the court's inherent equitable jurisdiction, in relation to dealing with beneficiaries' rights, the court will

provide effective assistance, by arriving at a practical and fair outcome, while ensuring that delay and costs are kept to a minimum.”

15. In the absence of any provisions in the CASS rules or in statute to deal with this situation, MFG UK and the administrators apply to the court for directions in the exercise of its inherent jurisdiction in relation to trusts.
16. The administrators propose a procedure, which has been adapted from the provisions of the Investment Bank Special Administration (England and Wales) Rules 2011 dealing with the submission and adjudication of claims by creditors. These rules are in turn based on the equivalent provisions of the Insolvency Rules. The proposed procedure is set out in schedule A, entitled Client Money Distribution Procedure, to the order which the administrators invite the court to make.
17. The proposed procedure is based on the express premise that any person claiming to have a client money entitlement and wishing to recover it in whole or in part must submit their claim in writing to the administrators. The administrators are entitled to call for any document or other evidence which they consider necessary for the purpose of adjudicating on the claim. The administrators may admit a claim in whole or in part. If a claim is rejected in whole or in part, the administrators must prepare a written statement of reasons to be sent to the claimant. In those cases where the administrators have already rejected a claim in whole or in part, the administrators must send a notice to the claimant confirming the rejection. Any claimant who is dissatisfied with the administrators’ decision may apply to the court for the decision to be reversed or varied, such application to be filed with the court within 21 days of receipt of the notice of rejection.
18. Where the administrators propose to make a distribution of client money, they will be required to give notice of it, directly to claimants whose email addresses or other contact details are known to the administrators and by way of advertisement on the website for the administration of MFG UK and in certain newspapers. This would apply to the first distribution, but subsequent distributions need be notified only by means of advertisement on the website, provided that proper notice has been given that this course will be followed. The notice must specify a date, not less than 21 days after the notice, by which claims must be lodged in order to qualify, if accepted, for participation in the proposed distribution.
19. Unless a claim has already been dealt with, the administrators must admit, reject or provide for the claims that have been submitted within 14 days after the specified date. Where a claim is rejected in whole or in part and the claimant applies to court to reverse or vary the decision, the administrators must on being given notice of the application provide in full for the rejected claim.
20. This procedure, if adopted, will meet the difficulties posed by both the existence of rejected claims and the possibility of unknown claims.
21. The order for which the administrators apply, and to which the client money distribution procedure is scheduled, provides that if the administrators give notice of intention to make a distribution, they shall be at liberty to proceed with the distribution on the basis that, first, the only persons with a claim to client money are

those who have lodged a claim by the last date for making claims specified in the notice of distribution and, secondly, that any claim which has been rejected is not to be treated as a claim to client money, unless the claimant has given notice of application to the court to vary or reverse the rejection. The order further provides that if the administrators act in accordance with these provisions, neither MFG UK nor the administrators shall have any liability with respect to a distribution to any client who subsequently establishes its claim. The order does not purport to vary the beneficial interests of any clients and, accordingly, provides that the exclusion of any claimant from such a distribution is without prejudice to their right to participate in any subsequent distribution from the client money trust, if they duly establish their claim, and is also without prejudice to any tracing or similar remedy that might be available to them.

22. The FCA is content with the adoption of the procedure proposed by the administrators, save that pending further information, it wishes the 1,393 undecided claims with a total value of US\$71.3 million to be fully reserved at this stage. The proposed scheme makes provision for this.
23. The making of this application has been notified to all known claimants. None has appeared to oppose the application.
24. Assuming that the court has jurisdiction to make the order sought, I have no doubt that it is in the best interests of the proper administration of the client money trust and in the best interests of the clients that the order should be made and the Client Money Distribution Procedure adopted. The beneficiaries are all companies or individuals who dealt as clients with MFG UK as an investment firm and did so within the relatively recent past. There has been a good deal of publicity surrounding the insolvency of the MF Global group and the administration of MFG UK and the administrators have communicated extensively with clients and others who dealt with the firm. It is highly unlikely that clients are unaware of the current situation and they can be taken to know of the facts which would entitle them to make a claim to client money. The overriding interest of all clients is to participate in distributions of the client money as soon as that is practicable. The procedures proposed by the administrators give claimants a full opportunity of lodging and pursuing their claims if they have not already done so. In the circumstances of MFG UK and its clients, it seems to me reasonable that the onus of pursuing a rejected claim should lie on the claimant, rather than imposing on the administrators the requirement to seek the determination of the court in respect of all such claims.
25. The issue is therefore whether the court has jurisdiction to make the order sought by the administrators. There is no relevant statutory jurisdiction. Section 27 of the Trustee Act 1925 (as amended) does not appear to apply to a trust such as the client money trust and, in any event, would only enable the administrators to disregard the possible existence of claims which were not notified following advertisement in accordance with that section. The court does, however, have an inherent jurisdiction in relation to trusts. In *Schmidt v Rosewood Trust Ltd* [2003] 2 AC 709, Lord Walker of Gestingthorpe said at [36]:

“It is fundamental to the law of trusts that the court has jurisdiction to supervise and if appropriate intervene in the administration of a trust, including a discretionary trust.”

In *Finers v Miro* [1991] 1 WLR 35, to which I will refer below, Balcombe LJ said at p.45:

“What gives the court jurisdiction is the fact that the plaintiffs undoubtedly held assets for the defendant and are also potentially liable as constructive trustees at the suit of the insurance company. English law has always imposed strict liabilities on trustees but in return has been ready to allow trustees to come and seek the directions of the court if they need to do so.”

26. The inherent jurisdiction of the court does not enable the court to vary beneficial interests in trust property but, as part of the jurisdiction to supervise and administer trusts, it permits the court to give directions to trustees to distribute trust property on particular bases when the court is satisfied it is just and expedient to do so. A well-established example of the exercise of the jurisdiction in this respect is the making of *Re Benjamin* orders. In those cases where the trustees are faced with a practical difficulty in establishing the existence of possible beneficiaries or other claimants, the court will give a direction to the trustees enabling them to distribute the trust property on an assumption of fact that there is no such beneficiary or claimant. As Nourse J explained in *Re Green's Will Trust* [1985] 3 All ER 455 at 462, a *Re Benjamin* order does not vary or destroy beneficial interests but merely enables trust property to be distributed according to the practical probabilities. It protects trustees but it equally preserves the right of any person who establishes a beneficial interest to pursue such remedies as may be available to them.
27. In *Re Benjamin* [1902] 1 Ch 723, the trustees were given liberty to distribute the testator's residuary estate on the basis that one of his sons, who had disappeared, had pre-deceased the testator and would on that basis not be entitled to share in the residuary estate. In *Re Gess* [1942] Ch 37, a similar order was made as regards any creditors in Poland of the deceased. Because of the war, it was impossible to advertise in Poland for claims. Moreton J acknowledged that it would be an extension of the decision in *Re Benjamin* to apply it to creditors, rather than beneficiaries, but it “would only be following the principle of that decision”. The basis for such orders was “evidence of the practical impossibility of proof of the fact or event sought to be established”. In *Re Green's Will Trusts*, a similar order was made as regards the son of the testatrix who had gone missing during a war-time bombing raid and had subsequently been certified by the Air Ministry as presumed dead. Nourse J said at page 462:

“I do not think that the question whether such an order should be made depends on whether or not there will be administrative inconveniences caused by the trustees retaining the fund. I think it depends on whether in all the circumstances the trustees ought to be allowed to distribute and the beneficiaries to enjoy their apparent interests now rather than later.”

A recent example was *Capita ATL Pension Trustees Ltd v Gellately* [2011] EWHC 485 (Ch) in which Henderson J made a declaration that the trustees of a pension scheme should be at liberty to administer the scheme on the basis that the only members of a particular class entitled to certain more generous benefits than other

members were the members listed in a schedule to the order. The judge was satisfied that the trustees had properly undertaken the exercise of trying to identify the relevant members and that it was appropriate to make the order, which made clear that further members could be added to the class if evidence of their entitlement came to light in the future.

28. A *Re Benjamin* order will be sufficient to protect the administrators as regards all possible claimants of whom they are unaware. I am satisfied by the evidence that the administrators have taken all reasonable steps to identify or notify potential client money claimants, particularly in the light of the publicity surrounding the insolvency of the MF Global group.
29. That part of the proposed order which would permit the administrators to distribute the client money held by them, without providing for those claims which are rejected in whole or in part but in respect of which no appeal to the court is made, would not simply be an application of the decision in *Re Benjamin* and the subsequent similar cases. Those cases permit the trustee to act on a presumed fact in circumstances where it is impossible or impracticable to establish the fact one way or the other. In the case of rejected claims, there is no doubt that the claimant exists and that they have asserted claims which have not been finally been determined by agreement, withdrawal or decision of the court. The basis of the proposed order is that the administrator should be permitted to proceed with the distribution of client money on a presumption that the only good or potentially good claims are those which have been agreed and those whose rejection is the subject of an appeal to the court.
30. The fact that the proposed order does not in this respect neatly fit within the *Re Benjamin* line of cases does not mean that it falls outside the proper scope of the inherent jurisdiction of the court. In the context of third party claims to trust property, it is stated in *Lewin on Trust* [18th edition] at para. 27.34:
- “It is the practice of the court not generally to permit a trustee to distribute without notice to a claimant. But the court has jurisdiction to permit or direct a trustee to distribute notwithstanding the existence of claims or potential claims from third parties. That will not have the effect of destroying a proprietary right of third parties, but may afford protection against personal claims against the trustees by third parties.”*
31. If such orders can be made in the context of third party claims to the trust property, I can see no reason in principle why such orders cannot also be made in the context of rejected claims to a beneficial interest. There is no fundamental distinction between the two categories of claims in this context. In *Finers v Miro*, to which I earlier referred, the Court of Appeal permitted a solicitor holding funds on behalf of a client to release a part of the fund to the client notwithstanding the existence of a constructive trust claim by a third party. As the passage from the judgment of Balcombe LJ earlier cited shows, the order was made in the exercise of the court’s inherent jurisdiction. At page 46, Balcombe LJ said:

“In my judgment the court undoubtedly has jurisdiction to authorise payment out by a trustee who, as in this case, prima facie holds his assets for a named person absolutely, although

*with the possibility that there may be other persons interested
in those assets.”*

32. The purpose of the court's inherent jurisdiction is to enable practical effect to be given to a trust. As earlier mentioned, the purpose of the client money trust established by the CASS rules and the purpose of the client money distribution rules in CASS 7A is to protect the position of clients and to facilitate the timely return of client money in the event of the failure of the firm. These purposes are not well-served by long delays while at considerable expense claims, which have been made but not pursued, are finally determined through court proceedings. If those persons who have made claims are seriously concerned to pursue them, it will be open to them under the administrators' proposals to lodge an application with the court, in which event full provision will be made for their claims while they are litigated. In my judgment, these proposals properly balance both the interests of established clients to a timely return of their money and the interests of persons with serious but unresolved claims to be treated as clients.
33. Accordingly, at the hearing of the administrators' application, I made the order sought by them.