[2011] IEHC 399

THE HIGH COURT

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[2011 No. ~~119~~ MCA]

IN THE MATTER OF CUSTOM HOUSE CAPITAL LTD. (No.2)

AND IN THE MATTER OF AN APPLICATION UNDER
ARTICLE 166 OF THE EUROPEAN COMMUNITIES
(MARKETS IN FINANCIAL INSTRUMENTS) REGULATIONS 2007
AND IN THE MATTER OF AN APPLICATION
BY THE CENTRAL BANK OF IRELAND

JUDGMENT of Mr. Justice Hogan delivered on the 28th October, 2011

1. In the late evening of 15th July, 2011, on the *ex parte* application of the Central Bank of Ireland, I made an order pursuant to Article 166(1) of the European Communities (Market in Financial Instruments) Regulations 2007 (S.I. No. 60 of 2007) ("the 2007 Regulations") providing for the appointment of two inspectors, George Treacy and Noel Thompson, to Custom House Capital Ltd. ("CHC"). Mr. Treacy is the head of the Investments Service Providers Supervision division of the Central Bank and Mr. Thompson is an authorised officer within that division. I shall refer to the Mr. Treacy and Mr. Thompson as the inspectors.

2. I gave the reasons for my decision to appoint the inspectors in a judgment delivered on 18th July 2011: see *Re Custom House Capital Ltd.* [2011] IEHC 298. The purpose of this judgment is to explain the reasons why I directed the liquidation of CHC with immediate effect in accordance with the powers conferred on the Court by Article 171(1) of the 2007 Regulations.

The Inspectors' Report

3. Subsequent to the appointment of the inspectors, they proceeded immediately to investigate into and report on the affairs of CHC. With admirable efficiency they conducted an investigation and took evidence from the directors, officers and employees of CHC. The inspectors complied rigorously with the directions and time-lines suggested by this Court. This culminated in a comprehensive and most impressive report delivered to this Court on 19th October, 2011.

4. At an inter-*partes* hearing on 21st October, 2011, I directed that a redacted version of that report be published pursuant to Article 171(2)(c)(ii) of the 2007 Regulations. The redactions in question were necessary to ensure that neither the investors nor their bank account details should be identified. These are precisely the type of redactions which Article 171(3) envisages should be made by the Court.

5. Article 171(2) requires the Court to forward a copy of the report to the Central Bank. I further directed that a copy of the report should be sent to the Director of Public Prosecutions, Director of Corporate Enforcement, the Minister for Justice and Defence, the Revenue Commissioners and the Garda Commissioner. Each of these personages and entities have a clear and obvious interest in receiving a copy of the full report and its detailed appendices (together with the confidential report supplied to me by the inspectors in accordance with Article 171(1), the nature of which I will presently describe). This is line with the approach adopted by Kelly J. in *Re National Irish Bank Ltd. (No.3)* [2004] 4 I.R. 186 at 191-192.

The activities of CHC

6. CHC was authorised under Article 11 of the 2007 Regulations to carry out the provision of asset, portfolio and investment management services, as well as pensions advisory services. Prior to the entry into force of the 2007 Regulations, CHC had also been authorised under the corresponding provisions of the Investment Intermediaries Act 1995.

7. CHC acted as a promoter and investment manager to CHC Investment Property Funds plc ("CHC Property"). This company was authorised by the Central Bank as a qualifying investor designated investment company under Part XIII of the Companies Act 1990 ("the 1990 Act"). A qualifying investor fund is a non-UCITS collective investment scheme which targets institutional investors and high net worth individuals, with a minimum investment of €250,000. CHC has about 1,500 clients, the majority of whom reside in the State.

The Inspectors' Findings

8. The Inspectors' findings make for grim and disturbing reading. They concluded that in almost every respect that there had been systematic abuse of client funds for improper purposes and that this misconduct was pervasive within CHC. CHC's core activities related to the purchase of investment properties, principally in countries such as France, Switzerland and Germany. But many of the investors were unaware that their cash funds were being used for this purpose. In other cases, money was taken from accounts where there were positive cash balances in order to meet the redemption call amounts due on other accounts.

9. In fact, the report describes a long litany of general misfeasance and wrong-doing, ranging from the systematic deliberate misuse of funds, gross impropriety, corporate misfeasance and false accounting to trading in a fraudulent manner. Under ordinary circumstances the contents of this report would be regarded as deeply shocking, save that, sadly, our capacity to be shocked by nefarious conduct in the financial world has been diluted by incredible and remarkable events over the last three years both at home and abroad, of which the Madoff scandal is only perhaps the most notorious international example. It was, nevertheless, in its own way telling that Ms. McGrath, counsel for the CHC, expressly stated that the company did not dispute the inspectors' findings and conclusions.

10. As against that general background, few should be surprised to learn that the inspectors also separately supplied with the Court with a confidential report in accordance with Article 171(1) of the 2007 Regulations. In this separate report the inspectors set out the details of the "matters coming to [their] knowledge as a result of the investigations tending to show" that criminal offences which they consider may have been committed. For manifestly obvious reasons, this separate report has not been published. Beyond recording the fact that I received this confidential report and that I directed that this separate report also be sent to the Director of Public Prosecutions, Director of Corporate Enforcement, the Minister for Justice and Defence, the Revenue Commissioners and the Garda Commissioner, it would be prudent that I should abstain from making any further comment on questions of possible criminal liability at this juncture.

Whether CHC should be wound-up?

11. It is plain from the inspectors' report that, on any view, CHC was insolvent. It cannot pay its debts as they fall due and the inspectors concluded that its recoverable assets are less than its balance sheet liabilities. The inspectors concluded that the misuse of funds which they had identified was in the region of €66m. The question which then arose at the hearing before me on 21st October, 2011, was whether the Court should then immediately appoint a liquidator to CHC.

12. Counsel for the various investors, Mr. Delahunt, urged me not to take that precipitative step until his clients had a full opportunity to read the inspectors' report and digest its contents. He envisaged a delay of perhaps some two weeks before any such decision could be made. While not unsympathetic to that submission, in my judgment, the circumstances were so serious that immediate action was called for.

13. Article 172(1) of the 2007 Regulations provides that:-

> "Having considered a report made under Regulation 171, the Court may make such order as it thinks fit in relation to matters arising from that report including –
>
> (a) an order of its own motion for the winding-up or dissolution or bankruptcy of an investment firm or the market operator of a regulated market."

14. In *National Irish Bank* Kelly J. had to consider a similar issue where the High Court was vested with virtually identical powers in s. 12 of the Companies Act 1990 (as amended). In that case Kelly J. held that this power was exceptional, inasmuch as it was vested in a court. This is thus very different from the conventional case where the application is moved on the application of a petitioning creditor.

15. Kelly J. went on to hold that the power should be exercised where the public interest so required it. The issue in *National Irish Bank* arose following the presentation of an inspectors' report which (as here) reported adversely in the running of the institution concerned. Critically, however, neither the inspectors nor have of the other parties before the Court had sought the winding up of the bank. While there were adverse findings of the "utmost gravity" contained in the inspectors' report, the Bank had since taken to steps to refund moneys to overcharged customers and to discharge substantial Revenue liabilities. It had thus manifested a firm purpose of amendment.

16. Just as critical was the effect such a winding-up would have had for the Irish banking system, since it was clearly a bank of systemic importance. A winding up order would have manifestly sent shock waves through the Irish banking system and affected confidence in the Irish banking system generally. It was for those reasons that Kelly J. held that it would not have been in the public interest to wind up the Bank.

17. The present case is very different. First, in this instance, the inspectors have sought the winding-up of CHC. Given that they are senior officials of the Central Bank, the relevant regulator in this area, their views must weigh heavily with the court. Second, it could not be said that CHC is of systemic importance to the Irish financial system in the way that a credit institution such as National Irish Bank clearly was. Third, it is clear that it would be in the interests of the creditors *as a whole* that CHC be wound up at this juncture.

18. One might elaborate on the latter observation by noting that in the latter years of its operation, CHC's trading system exhibited some classic features of a typical Ponzi scheme. It must, of course, be accepted that that CHC engaged in perfectly

legitimate trading and, moreover, unlike classical Ponzi schemes, investors were neither promised - and nor did they expect - returns which were simply too good to be true. The origins of the problems at CHC nevertheless seem to date, however, from the onset of the credit crunch in 2007 when the company found itself overcommitted to European property deals and found itself in difficulty when the prospective investors declined to invest.

19. As the inspectors explain (at para. 23.1):-

> "As the flow of fresh investment into property projects ceased, in fear of loss of the initial deposit and damage to its reputation, CHC sought to cover the investment shortfalls through the creation of products as such as the Mezzanine Bond and eventually through the misuse of client holdings described in the report."

20. From that point onwards, CHC took the long slide towards perfidy and ultimate oblivion. By the end, CHC was exhibiting some of the classic characteristics of a full blown Ponzi scheme. The accounts of customers with cash balances were being raided to cover deficits elsewhere to give the impression that CHC was solvent and trading normally. False accounting had become almost the norm and, unfortunately, clients were deceived as to the true state of their cash balances and the trading position of the company.

21. It could not be in the public interest that such systemic and pervasive misconduct could be tolerated for an instant. Moreover, following the presentation and publication of the report, it is clear that, absent the protections involved in a court-directed liquidation and administration, the affairs of CHC would collapse in a disorderly and chaotic fashion. The collapse of Ponzi-style schemes inevitably results

in a form of immediate bank run on the liquid assets of the company and the position of CHC would probably be no different.

22. Thus, absent such statutory protections, some creditors would be likely to be repaid in a haphazard fashion and even then, this would very probably be at the expense of other investors who were similarly circumstanced. Given the extent to which false accounting had become the norm at CHC, the risk of injustice to innocent investors would be considerable, since none of the client cash statements could be taken at face value. None of this could be regarded as being in the public interest. The only solution was an immediate court sanctioned liquidation where the liquidator would take steps to conserve the assets of the company and to ensure that payments out were made to creditors in a manner authorised by law.

Conclusions

23. It was for these reasons that I concluded that there was no alternative to the immediate winding up of CHC in the public interest in accordance with the powers conferred on the Court by Article 171(1) of the Regulations and the appointment of Mr. Kieran Wallace as liquidator with immediate effect.

Gerard Hogan
4th November 2011