# THE HIGH COURT

[2011 No. 119 MCA]

**IN THE MATTER OF CUSTOM HOUSE CAPITAL LTD.**

**AND IN THE MATTER OF AN APPLICATION UNDER**

**REGULATION 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 18th July, 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 MiFID Regulations") providing for the appointment of two inspectors, George Treacy and Noel Thompson, to Custom House Capital Ltd. ("Custom House"). 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. Since this was the first occasion an application of this kind has been by the Central Bank, it seems appropriate that the reasons for my decision be set out briefly in writing.

**The background to the application**

**2.** Custom House is an investment fund management firm which was incorporated in 1997 with its registered office in Merrion Square, Dublin 2. In March, 2011 the firm reported to the Central Bank that it had approximately assets in value to some €1.15bn. under management on behalf of its clients and that it held approximately €24m. in cash in designated client accounts.

**3.** Between 2009-2010 there were extensive contacts between the Central Bank and Custom House following the receipt of information from an individual to the effect that some clients' monies were being invested without their knowledge or consent in an investment framework described as the Mezzanine Bond Fund. According to Custom House's own promotional literature, it appears that the fund had been created in order to enable it (i.e., Custom House) to assist in the short term financing of properties in the European market.

**4.** Along with members of the prominent accountancy firm, KPMG, Mr. Thompson was then appointed as an authorised officer to investigate a sample of property transactions which included such mezzanine financing. Further directions were then given under the MiFID Regulations. These included a requirement that Custom House clarify the financial position of each syndicated special purpose vehicle for individual properties by reference to identifying current valuations compared with the valuation at the time of purchase along with any shortfalls in equity being raised and that the level of regulatory capital be raised to €5m. to cover potential liabilities arising from the Mezzanine Bond.

**5.** Further directions issued in April 2010 and these directions were (with one minor exception) renewed in April 2011. These directions included a direction not pay

any dividends to shareholders or to provide any loan to a director. Significant restrictions on the right of the firm to advertise for or solicit new business were also imposed.

**6.** In February, 2011 the Central Bank wrote to Custom House and Mr. Harry Cassidy (the chief executive officer) alleging breaches of regulatory requirements relating to the sale of the mezzanine bond to clients and an administrative sanctions procedure under Part IIIC of the Central Bank Act 1942 (as amended) was initiated. Responses were supplied by Custom House in April, 2011.

**7.** So far as the mezzanine bond is concerned, the evidence to date suggests that over €10m. is owed to investors. The regulatory capital requirement of €5m. which the Central Bank imposed has been varied to take account of the fact that Custom House now has to deduct any contingent liability arising on the mezzanine bond when calculating its regulatory capital. A further complication is that the Central Bank maintains that inconsistent views have been expressed by Custom House as to whether the mezzanine investors rank *pari passu* with ordinary equity investors in the special purpose vehicle or whether the former enjoy priority. This uncertainty clearly had implications for the question of whether Custom House's capital reserves were adequate for this purpose.

**8.** These developments obviously gave grounds for concern. These concerns were plainly heightened by developments which have taken place within the last few days. According to the grounding affidavit sworn by Mr. Thompson, a senior staff member of Custom House requested a meeting with Central Bank on 11th July. At that meeting, the staff member concerned expressed concern that monies may have been taken from pooled client asset accounts by Custom House without appropriate

authority and used to cover shortfalls in property investments on behalf of clients. It was similarly contended that equity unit trusts and cash unit trusts were also improperly used in this way. There is concern that the shortfall in respect of the trust assets may be upwards of €13m.

**9.** Running in tandem with this are the separate concerns voiced by Appian Asset Management Ltd. ("Appian") and Mr. John O'Dwyer, the Chairman of Custom House. Appian entered into a services agreement with Custom House in May, 2011 and it is duly authorised under the MiFID Regulations for this purpose. In the course of familiarising itself with the services to be rendered, Appian became aware of certain apparent discrepancies in records of the firm relating to some clients. These included incomplete information between valuations of assets supplied to certain clients and the underlying records of Custom House relating to those client's accounts, along with other issues relevant to the security and good order of the holding of client assets. In the light of these developments it appears that Appian are now taking steps to terminate their appointment with Custom House. It is proper to record that Appian at all times have acted with utmost propriety and have been very helpful and co-operative with the Central Bank.

**10.** Mr. O'Dwyer had been asked to join the firm as a non-executive director in 2009 in the wake of a request from the Central Bank to strengthen the board by bringing in an experienced outsider who could assist the independence of the decision making within the company. To that end, Mr. O'Dwyer agreed to join Custom House in July 2010 and he subsequently took over the role of Chairman in late 2010. It is equally proper to record that Mr. O'Dwyer's integrity is beyond question and that illness this year hampered his ability to perform his task as Chairman.

**11.** On 11th July Mr. Thompson received a telephone conversation from Mr. O'Dwyer in which the latter stated that he could no longer regard the information he received from Custom House as dependable. While senior figures within the company had assured Mr. O'Dwyer over the weekend of July 9-10 that investor monies had not been misused, he now considered that the opposite was the case. Shortly after this development senior figures within the company either resigned or communicated their intention to do so. At that point the Bank issued further directions requiring Custom House to desist from making any payments to investors and resolved to make this application.

**12.** For completeness, I should record that Mr. Treacy gave evidence before me at the hearing of the *ex parte* application of a further meeting with senior staff on 14th July, all of whom expressed similar concerns, including concerns regarding the reliability of information relating to customer accounts.

**The nature of the application**

**13.** Article 166(1) of the MiFID Regulations provide:-

> "Without prejudice to the powers of the Bank under these Regulations, where the Bank is of opinion that it is interests of:-
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> (a) the proper and orderly regulation and supervision of investment firms or regulated markets, or
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> (b) the protection of investors,
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> that an investigation should be held into the affairs of an investment firm or the market operator of a regulated market, the Bank may apply to the Court for an order authorising such an investigation."

**14.** I would pause here to observe that the requirement that the Bank should be "of opinion" that it would apply to this Court under Article 166(1) should be understood as importing the requirements that the Bank must act bona fide in a reasonable fashion and that the underlying facts on which it bases its opinion are factually sustainable: cf. by analogy the comments of Blayney J. in *Kiberd v. Hamilton* [1992] 2 I.R. 257, 265. Without necessarily expressing any final view on this question, not least given that the present application is *ex parte*, everything suggests that these three conditions are satisfied.

**15.** Article 166(2) empowers the Court, as it thinks proper, to appoint one or more inspectors to conduct the investigation on the application of the Bank. Article 166(2)(b) provides that the inspectors must report the results of the investigation in such manner as the Court may direct.

**16.** Article 166(3) provides:-

> "Before applying to the Court to appoint an inspector under this Regulations, the Bank, if it is of the opinion that it would not be prejudicial to the interests of shareholder or creditors or investors, may notify the investment firm or the market operator concerned in writing of:-
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> (a) the application, and
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> (b) reasons for the application,
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> and, in that case, the investment firm of the market operator, within such period as the Bank may set out in the notification, shall be entitled to give to the Bank a statement in writing explaining the relevant activities of the investment firm or market operator, as the case may be."

**17.** In the present case the Bank did not give advance notice of its intention to apply to this Court to seek to have inspectors appointed. Again, without necessarily expressing any final view on this question having regard to the *ex parte* nature of this application, one can immediately appreciate why, in the light of the information already in its possession, such advance notification of this application was not given by the Bank.

**18.** This brings us directly to the nature of the order sought. Counsel for the Bank, Mr. Barniville SC, submitted that in such circumstances that any order which I made under Article 166(2) appointing inspectors to investigate the affairs of Custom House was in the nature of a final order, albeit that it was accepted by counsel that Custom House should be given liberty to apply to have the order set aside. If that were the case, this would have the effect that a final order could be made with significant reputational, financial and other implications for a company without any advance warning or notice or without it having been given the basic opportunity to make its case.

**19.** In my view, such a construction of Article 166(2) would have to be rejected as unconstitutional as being inconsistent with the constitutional guarantee to fair procedures. The task of this Court on an application of this kind is not simply, so to speak, to beautify by judicial order by purely formally confirming what might seem to many as the inevitable necessity of a full scale investigation to be conducted by Central Bank inspectors. It is rather to ensure that there is, objectively speaking, a necessity for an investigation and that the procedural and, where merited, the reputational rights of the company are appropriately safeguarded by the judicial branch. It is true that the allegations here are very serious and, at first blush, would appear to be supported by an abundance of evidence. But if justice is to be

administered in an even handed fashion, it means that Custom House must be given an effective opportunity to demonstrate why the making of an order under Article 166(2) is not warranted. It is true that the finality of the order might be tempered by giving Custom House the opportunity to apply to have the order set aside, but even in such circumstances the burden of proof which the Central Bank as applicant should properly carry would effectively be reversed.

**20.** This is underscored by two leading decisions of the Supreme Court: *DK v. Crowley* [2002] IESC 66, [2002] 2 I.R. 712 and *Dellway Investments Ltd. v. National Asset Management Agency (No.2)* [2011] IESC 14. In *DK* the Supreme Court held that s. 4 of the Domestic Violence Act 1996 was unconstitutional insofar as it permitted the District Court to make an order in an *ex parte* fashion *without* providing *at the same time* for appropriate procedural safeguards. As Keane C.J. noted, this had the effect that a person affected by such an order might be excluded from their family home by an order of indefinite duration. The Court observed, however, that it was ultimately the lack of appropriate procedural safeguards which led it to the conclusion that the section represented a disproportionate interference with the constitutional right to fair procedures ([2002] 2 I.R. 744 at 760):-

> "It is undoubtedly the case that the respondent may apply to the court at any time to have the interim order discharged or varied. No reason has been advanced, however, presumably because there is none, as to why the legislature should have imposed on respondents in this particular form of litigation, with all its draconian consequences, the obligation to take the initiative in issuing proceedings in order to obtain the discharge of an order granted in his or her absence which, it may be, should never have been granted in the first place. It has not been demonstrated that the remedy of an interim

order granted on an *ex parte* basis would be in some sense seriously weakened if the interim order thus obtained were to be of a limited duration only, thus requiring the applicant, at the earliest practicable opportunity, to satisfy the court in the presence of the opposing party that the order was properly granted and should now be continued in force.

The court fully appreciates the considerations which the executive and legislature would have had in mind in providing for the granting of interim barring orders on an *ex parte* basis. In the many cases where the spouses are still living together and one is being subjected to violence by the other which may also extend to the children, it may simply not be practicable for the application to be made on notice to the respondent. It is not the existence of a jurisdiction to grant interim barring orders on an *ex parte* basis which creates a serious constitutional difficulty. It is the manner in which the legislation has provided for the granting of such orders."

**21.** It is clear from this passage that the mere fact that the person or entity affected by a far-reaching order of a final nature granted *ex parte* can apply to have the order set aside may not in itself sufficient protect the legitimate procedural rights of the person so affected.

**22.** In *Dellway Investments* the Supreme Court held that the National Asset Management Agency was required to give borrowers an opportunity to be heard before their loans were transferred from commercial banks to the agency. The Court stressed the reputation impact such a transfer might have and it also noted that the statutory powers of the Agency were far more extensive than those enjoyed by commercial banks. Applying standard *East Donegal* principles (*East Donegal Co-Operative Ltd. v. Attorney General* [1970] I.R. 317) the Court rejected a construction

of the National Management Agency Act 2009 which would have excluded the right to fair procedures in the circumstances.

**23.** As Murray C.J. put it:-

> "In the course of the hearing it was at one point argued on behalf of the State that the exclusion of a right to a hearing might be justified by reason of the crisis affecting the national banking system and the urgency of the measures needed to counter systemic threats to that system. I have to say that there was no evidence or material before the High Court to suggest that the time involved in permitting persons such as the appellants to make representations to NAMA before it made a final decision would impinge on, let alone be fatal for, its effective functioning. Moreover I find it difficult to envisage circumstances where the principles of constitutional justice ensuring that decisions are fair for the individual could be overridden. To do so would be to abrogate a constitutional protection which every citizen enjoys when the State decides to exercise a power which encroaches on individual rights.
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> The State in exercising its powers through the organs of government designated by the Constitution have extensive powers to regulate and limit the exercise of individual rights in the interest of the common good and this may be relevant where the State is faced with a national crisis, such as one of a fiscal nature. The State has the power to act in the interests of the common good because the Constitution, in its provisions, expressly envisages that. It also envisages that in exercising such powers the State must act within the ambit of the Constitution as a whole. In a democratic State founded on the rule of law there are definite limits to the extent to which the State can interfere

with or restrict constitutional rights or rights vested in or acquired by individuals - freedom of expression, assembly, freedom of religion, right to education, right to earn a livelihood, property rights (including contractual rights), right to strike - to name but some, even when it is acting or purporting to act in the interest of the common good in a national crisis. In common with international instruments, such as Covenants of the United Nations and the European Convention on Human Rights, the Constitution envisages that rights may be regulated and limited but not to an extent that it is disproportionate or in a manner which is arbitrary or discriminatory in an invidious sense. In particular the State cannot act in a manner which would abrogate a right or deprive it of its very essence.

If the State were to succeed in its argument, namely that the Act of 2009 prohibits NAMA from giving any consideration to representations from persons in the position of the appellants, it would be denying the very essence of a right to a hearing, a concept at the core of the principle of constitutional justice and due process."

**24.** In the light of these authorities, I could not constitutionally sanction the appointment of inspectors by means of the making of a final order on an *ex parte* basis. It cannot be said that such an appointment represents merely some routine procedural step and that Custom House will have its opportunity of defending its position before the inspectors. It is rather a step which will have significant reputational issues for the company, whose business may be severely affected by the publicity attendant on such appointment. This is much more comparable to a decision by a professional body to commence an investigation into a professional person, a

decision which in itself attracts the right to fair procedures: see, *e.g.*, *An Bord Altranais v. O'Ceallaigh* [2000] IESC 21, [2000] 4 I.R. 54.

**25.** It follows, therefore, that the application of Article 166(2) must be re-fashioned somewhat beyond its bare language in order to make it operate, *East Donegal*-style, in a constitutional fashion by, if necessary, interpolating appropriate safeguards in order to vindicate the company's constitutional right to fair procedures and, indeed, the protection of its property rights in the manner required by Article 40.3.1 and Article 40.3.2 of the Constitution. If the *ex parte* nature of the original appointment can be justified on the basis that it was necessary so to act in order to protect investor funds, the principle of proportionality correspondingly requires that this must be counter-balanced by a stipulation that the appointment be in the nature of an interim order or on a provisional basis.

**Conclusions**

**26.** I will accordingly stipulate that the order under Article 166(2) be made returnable to this Court for Wednesday, 20th July. In the event that the making of such an order is challenged by Custom House, then it will be necessary for the Central Bank to renew the application for the appointment of inspectors. Should that occur, then by analogy with the principles expressed by Keane C.J. in *DK,* the onus will rest with the Central Bank (and *not* on Custom House) to justify the continuation of the order.

Approved

Gerard Hogan

July 20, 2011