

# Court confirms when a transaction is void or unenforceable following an FCA rule breach

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In the context of a dispute over losses generated by Robert Tchenguiz, a property tycoon, through his account with an FCA-regulated firm, the High Court found that Mr Tchenguiz was liable to the firm for the outstanding debt. The decision clarifies when a breach of FCA rules will provide a customer with an absolute defence to a claim.

Dentons (Sarah Rutnah and Natasha Lowry) represented IG Index Ltd (**IG**), the successful claimant. David Mayall of Lamb Chambers was instructed as counsel.

## What was the dispute about?

Through a spread betting account with IG, Mr Tchenguiz placed bets that the share price of FirstGroup plc, a major public transport provider which operates Great Western Railway and other UK rail and bus services, would increase. Though initially classified as a retail client on account opening, Mr Tchenguiz applied for and was subsequently re-categorised as an Elective Professional Client (**EPC**).

FirstGroup plc's share price collapsed following COVID-19. IG was entitled to close out Mr Tchenguiz's open positions where the net equity on his account reached £0. At the point of close-out, Mr Tchenguiz had an outstanding balance in excess of £6.5 million.

Relying on the terms of the Spread Betting Customer Agreement, IG claimed against Mr Tchenguiz for the outstanding amount, together with interest in the amount of £592,398 at the time of the Claim Form.

Mr Tchenguiz denied liability on the basis that IG had incorrectly re-categorised him as an EPC. Retail clients were given negative balance protection (**NBP**) under the FCA's Conduct of Business Sourcebook (**COBS**) 22.5.17R, such that liability was limited to the funds in the account. Mr Tchenguiz alleged that the incorrect categorisation breached COBS 3.5.3R and 3.5.6R.

COBS 3.5.6R provides that a client can only be re-categorised as an EPC where the firm has taken all reasonable steps to ensure compliance with the following tests under COBS 3.5.3R:

- An evaluation of the client's expertise, experience and knowledge sufficient to give "reasonable assurance [...] that the client is capable of making his own investment decisions and understanding the risks involved" (the **Qualitative Test**).
- Satisfaction with at least two out of three listed criteria (the **Quantitative Test**).

## How did the court approach the issues?

### Was re-categorisation as EPC compliant with COBS?

The High Court found that IG's re-categorisation of Mr Tchenguiz fully complied with the two COBS provisions, which in summary required taking reasonable steps to ensure that the client was a sufficiently competent investor.

First, the Qualitative Test focuses subjectively on whether the firm is reasonably assured that the client is a competent investor. IG's policies clearly provided that it would only consider actual trading experience in relation to this test and set out a scoring system by reference to the relative complexity of products traded. In the court's view, this gave IG reasonable assurance of Mr Tchenguiz's competence and there was no basis for suggesting this approach was flawed.

As to the Quantitative Test, which required scoring against objective criteria, the key question for the court here was whether IG both obtained and reviewed evidence showing Mr Tchenguiz had at least one year's professional experience in the financial sector which required knowledge of comparable transactions. By considering other evidence (namely a High Court judgment concerning a prior dispute between Mr Tchenguiz and the Serious Fraud Office) to corroborate what Mr Tchenguiz said in his EPC application, IG had clearly satisfied the test.

In addition to the Qualitative and Quantitative Tests, Mr Tchenguiz had also alleged a separate breach of COBS 3.5.3(3) on the ground that warnings relating to his loss of NBP were not sufficiently clear. The judge agreed with IG's counsel that this argument was "hopeless" given Mr Tchenguiz himself had acknowledged the risk in his application.

### Assuming a breach, would Mr Tchenguiz have had a defence to the debt?

The court went on to consider obiter the position had it found a breach of the COBS rules.

Section 138E(2) of the Financial Services and Markets Act 2000 (**FSMA**) provides that a breach of FCA rules by an authorised person does not make a transaction void or unenforceable, though there are limited exceptions under section 138E(3) in the case of rules made under the FCA's more recent rule-making powers. Mr Tchenguiz argued that the breaches of COBS 3.5.3R and 3.5.6R invalidated the transaction with the result that he remained a retail client with NBP protection.

The court found that the Qualitative and Quantitative Tests were introduced under a power given to the FCA's predecessor, and so clearly fell within the rule in section 138E(2) rather than the exceptions in section 138E(3).

The position on a breach of COBS 22.5.17R was less clear, as the instrument which introduced it was made under five separate FCA powers, and so the question was how the provision should be categorised. Ultimately, the court found that COBS 22.5.17R also did not engage any of the exceptions under section 138E(3).

The only other potential defence to IG's claim was one of set-off: section 138D(2) provides for a damages claim to be made where an individual suffers loss as a result of the rule breach. However, Mr Tchenguiz had not brought any counterclaim for damages.

## What are the key takeaways?

The judgment is a useful reminder of the potential consequences of a rule breach under section 138E FSMA. The court's obiter comments make clear that whether a transaction is void or unenforceable ultimately depends on the categorisation of the rule: unless a firm has breached a rule which, properly categorised, falls within one of the limited exceptions in section 138E(3) FSMA, the transaction will stand and the only available recourse is a damages claim.

This was not the only such dispute involving Mr Tchenguiz: the court noted that he had taken out similar spread betting positions on the share price of FirstGroup plc with other providers, one of which was the subject of an earlier High Court judgment from 2022.

The judgment can be accessed [here](#).