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## **Burns v Financial Conduct Authority [2017] EWCA Civ 214: a sign of things to come?**

**Directors' duties, procedural fairness and issue based costs; the Court of Appeal decision sheds lights on several aspects of financial regulatory enforcement action.**

With the implementation of the Senior Managers Regime and its "duty of responsibility", alongside the FCA's avowed intention to increase its focus on individuals, we can expect more contested regulatory hearings involving individual financial professionals. That is particularly so where the wrongdoing may justify a prohibition order depriving that person of their livelihood, and a settlement is therefore unlikely.

Against that background the Court of Appeal's decision in **Burns v FCA [2017] EWCA Civ 2140** upholding the findings of the Upper Tribunal in the FCA's action against Angela Burns ("AB") is likely to become an important reference point on some key issues.

The main **take home points** are:-

1. An analysis of directors' duties regarding conflicts of interest, and the threshold at which an "interest" is enough that the director must declare it to her board.
2. Important guidance on procedural fairness, what must be pleaded by the FCA, and what may not be pleaded but nevertheless relied upon against an individual – particularly in the context of prohibition.
3. A discussion of the threshold for awarding unreasonable conduct costs, against the particular background of claims rejected by the Regulatory Decisions Committee ("RDC") of the FCA but nevertheless advanced before the Upper Tribunal.

### **Background**

AB was a senior finance professional carrying out various consultancy and Non Executive Director ("NED") roles over many years.

AB was a NED of two mutual societies ("the Mutual Societies") which were seeking an investment manager for funds. AB was involved in the introduction of Vanguard to those societies as a potential manager. AB had carried out consultancy work previously for Vanguard which involved orchestrating its entry to the UK market.

In the course of Vanguard's introduction to the Mutual Societies, AB solicited Vanguard by email for a NED role in its UK operations. In doing so she referred expressly to her NED role with the Mutual Societies as a reason why she would be suitable.

When Vanguard had been appointed by one Mutual Society, and was under consideration by the second, AB emailed Vanguard, asking that given that her NED positions at the Mutual Societies had already obtained £350m under management for Vanguard, would they pay her a fee of one basis point of new monies and give her a NED position, amounting to £130k p/a.

That email triggered an FCA investigation which culminated in a penalty of £20,000 for reckless breach of Principle 1 (want of integrity), and a prohibition order from CF2 activities following a finding that AB was not a 'fit and proper person' to perform CF2.

AB appealed from the Upper Tribunal to the Court of Appeal on three grounds.

### **Ground 1: Breach of Director's Duties regarding conflicts of interest**

The principal allegation was that AB had a duty to declare her interest in Vanguard to the Mutual Societies of which she was a NED, under s.177 of the Companies Act 2006 and equivalent legislation for friendly societies.

AB argued that she had no "interest" in Vanguard; she had asked for an NED role and remuneration but did not receive anything. There was nothing to declare. Moreover, she argued, at the time Vanguard's role with the Societies was remote and speculative.

The CA **Held** that it was enough that there was a "*real sensible possibility of a conflict*" [75]. An actual conflict was unnecessary. AB was actively soliciting Vanguard at the same time as the Mutual was entitled to her undivided loyalty, unclouded by any potential relationship between AB and Vanguard.

**Comment:** The focus on directors' duties itself is of note, showing that in determining where conduct falls below Principle 1 standards, it will be important to consider an individual's common law and statutory duties. The current Director of Enforcement Mark Steward has remarked that directors' duties (to the company) are "*Probably the closest statutory precedent for senior management liability*" under the Senior Managers Regime (in his speech on 31 March 2017 in New York), so this approach is set to continue.

Clearly the Mutual Societies would have wanted to know that the person who brought them Vanguard, and was obliged to advise on their appropriateness in a dispassionate way, was using her NED position to leverage a role with Vanguard. The outcome is unsurprising as a matter of law, even if some might regard it merely as an example of aggressive commercial practice.

### **Ground 2: Procedural Fairness**

There was an unpleaded allegation that AB had not been straight with the FCA and with the Mutual Societies about her recent previous employment with a firm (Pearl) which ended badly, i.e. in litigation which AB lost. This included a manifestly false declaration on her application to the FCA for CF2 status for the NED roles.

It will be recalled that the FCA alleged (1) breach of P1/lack of integrity, and (2) AB was not fit and proper. The Pearl disclosure point was not pleaded in respect of either limb.

Nevertheless in its closing submissions before the Tribunal the FCA argued that the Pearl non-disclosure should (and must) be taken into account on the issue of fitness and propriety, including general propensity to dishonesty. The Tribunal agreed. AB was unable to provide any good explanation for her non-disclosures, and the Tribunal relied on both the non-disclosure and AB's unsatisfactory evidence about it to the Tribunal, in upholding the prohibition order.

AB argued that the Tribunal should not have relied on unpleaded allegations. The FCA argued that in considering fitness and propriety the Tribunal should consider all matters arising from the evidence before it, regardless of whether pleaded.

The CA **rejected** the FCA's position. That was despite the comments of Stanley Burton LJ in *Hobbs v FCA* [2013] BUS LR 1290 suggesting that a s.57 FSMA reference is not ordinary civil litigation, but requires consideration of the public interest. In *Burns* the Court of Appeal arguably narrowed the scope of those remarks, putting an increased emphasis on the necessity to plead all acts and omissions on which unfitness is based.

The exception to that was the truthfulness of respondent's evidence to the Tribunal itself, which of course the FCA could not plead prior to the hearing, but which the Tribunal was entitled to consider.

The Court indicated that the seminal description of the importance of statement of case in *Rolled Steel Products v British Steel* [1986] Ch 246 and other civil cases applied equally to FSMA references to the Upper Tribunal. However, the principles developed in Directors' Disqualification Proceedings also applied, to the effect that in the public interest, the authority should be permitted to amend its case provided there is no unfairness to the respondent.

AB's appeal was also therefore dismissed. The FCA did seek to adopt the Pearl matter into its case in closing argument – the question was whether it was unfair on AB to permit it to do so. It was not unfair because at that point AB's counsel did not object to the change in case (a conclusion that is certainly debatable), but moreover the Tribunal gave AB extra time to file further submissions on the point, which she did.

**Comment:** This aspect of the decision is of potential significance since it deals with the respondent's right to procedural fairness in the Upper Tribunal in FSMA references, in general terms. Any respondent's lawyers should consider it carefully, as it is all too easy for a case to morph in the course of a hearing, with the opportunity to object being lost (as happened in this case).

The outcome was rather generous to the FCA, in that it was able to advance an unpleaded claim in closings. In a commercial case it is not uncommon to file an amended statement of case and seek permission to run it, even at that late stage. It was significant in *Burns* that in reality AB had no real defence to the unpleaded allegations.

### Ground 3: Issue Based Costs

Rule 10(3) permits the Tribunal to make a costs order where it considers that a party “*has acted unreasonably in bringing, defending or conducting the proceedings*”.

The FCA had argued that AB’s final request for payment and an NED position from Vanguard evidenced an intention to solicit a corrupt payment. That allegation failed. The Tribunal ordered the FCA to pay some £100,000 plus VAT in respect of AB’s costs of the issue.

The FCA appealed what was undoubtedly a highly unusual costs order given that AB had plainly lost overall and indeed that the Tribunal had found her guilty of serious impropriety.

The CA **dismissed** the FCA’s appeal.

The FCA’s difficulty was that the RDC had already dismissed the corrupt payment allegation. It was maintained by the FCA because of later revelations which were indicative of a lack of general probity on AB’s part, but those revelations did not bear on the email in question – they were entirely collateral.

The FCA argued that the Tribunal had wrongly applied a test requiring “*cogent reasons*” for the reintroduction of an allegation dismissed by the RDC. Certainly on one reading, that is what the Tribunal had done in [53] of its judgment.

The CA appears to have agreed that if the Tribunal had imposed such a test, it would be wrong (and inconsistent with the Rules), but found that it did not do so.

Rather, the Tribunal was simply making the point that the more serious the allegation, the more cogent the evidence required to make it, and there was no evidence which was not before the RDC which improved the prospects of succeeding on the intention to solicit a corrupt payment allegation.

**Comment.** Losing respondents should not overlook the possibility of seeking unreasonable conduct costs and issue based orders in the Upper Tribunal, particularly by reference to the timeline giving rise to the allegations. *Burns* makes such applications seem much less unusual.

It is also a reminder to investigation subjects that adopting the new Fast Track procedure to the Tribunal and bypassing the RDC could have tactical drawbacks, given that *Burns* is likely to have a chilling effect on the maintaining by the FCA of certain types of claim dismissed by the RDC.

On the facts of this case, AB’s email suggesting payment and a NED role also invited the recipient to refer the matter to his in house lawyers to progress. This, it was thought, was entirely inconsistent with the notion that she was seeking a corrupt payment, so the allegation was in reality hopeless.

Also of note is that the Tribunal found there was a lack of conscious awareness on AB’s part that her email raised any issues of propriety. The effect of the Supreme Court’s decision in *Ivy v Genting Casinos* [2017] UKSC 67 is of interest, in that dishonesty no longer requires a subjective element in criminal law, a decision which is anticipated to carry over into the

regulatory and disciplinary sphere. It might fairly be asked, in light of *Ivy*, why should it matter whether AB was unaware that her request was improper?

### **Conclusion**

This is a space to be watched, particularly as enforcement actions under the Senior Managers Regime start to gain traction.