Regulatory Penalties - An Update - Guidance From The Court Of Appeal

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On 27 May 2015, Ogier published an article examining the way in which the Guernsey Financial Services Commission (the **GFSC**) imposes sanctions and the scrutiny the same are subject to by the Royal Court of Guernsey (the **Court**). This followed the handing down of the Court's judgment in Bordeaux Services (Guernsey) Limited & Ors -v- The GFSC.

Since then, the Royal Court has handed down a further decision in the matter of David John Merrien -v- Cees Schrauwers (Chairman of the GFSC), part of which was then heard by the Court of Appeal on appeal by the GFSC [1].

Mathew Newman, a partner in Ogier's dispute resolution team, examines both decisions.

Royal Court decision

This took the format of an appeal challenging the decision of the GFSC to publish a short notice on its website in December 2013 stating that the Appellant was *"not licensed to carry out controlled investment business"* and that he was *"also not licensed to carry out long term insurance business"* under the respective laws mentioned therein. It also challenged a decision of December 2014 to: (1) make prohibition orders against the Appellant under the suite of regulatory laws, (2) dis-apply the exemption set out in section 3(1)(g) of the Regulation of Fiduciaries, Administration Businesses and Company Directors etc (Bailiwick of Guernsey) Law 2000 (the "Fiduciaries Law") and (3) to impose a financial penalty of £200,000 and to make a public statement under section 11D and 11C respectively of the Financial Services Commission (Bailiwick of Guernsey) Law 1987 (the "FSC Law").

Although the hearing was held in private, the Court stated that because the statement was already

public, it would be contrary to the principles of open justice to hear the case in private (hence the judgment being published) and that where the details of a decision under appeal involve a statement that has already been published, even if the parties did not agree to a public hearing, the Court was more likely than not to order one.

Statement on Website

Because the full suite of POI laws had been relied on for the making of the prohibition orders against the Appellant, he had to invoke the appeal provisions in each, as well as the provisions in the FSC Law.

The Court examined the relevant laws and found that there was no right of appeal available to the Appellant in respect of the decision to publish the notice in December 2013 or the ongoing decision to leave it there. Further, the Appellant had actually consented to the wording of such information when his advocate wrote to the GFSC before it was published, stating that it was *"perfectly acceptable"*. The Court did, however, observe that it was not sure why the GFSC felt it necessary to continue to have the notice on the website given that events had progressed to final determination, but that whether they wished to remove it was entirely a matter for the GFSC and not something on which the Court could rule as part of the appeal

Prohibition Orders

As regards the prohibition orders, it was alleged that there had been a material error as to the procedure followed, particularly the non-compliance by the GFSC with its own published Guidance Note on the Decision Making Process. Paragraph 9.6.5 of the Guidance Note stated that the decision-maker would make sure that the party was aware of and had access to the Guidance Note. The GFSC were unable to point to anything to show compliance with this requirement and the Appellant invited the Court to draw an inference that the Guidance Note was not referred to. The Court declined to do so stating that the Appellant was asking the Court to make an inference that was not warranted. The Court held that what mattered was whether there had been broad compliance with a fair procedure such that if the overall impression was that the relevant stages had been followed and the Appellant had been dealt with fairly, the ground of appeal fell away.

Who can attend meetings with the GFSC?

Paragraph 10.2 of the Guidance Note indicated who may be in attendance at meetings with the GFSC and in this case, there were more officers of the GFSC present than usual. The Appellant had commented towards the end of the meeting that *"I feel I am severely outnumbered and I feel pressured into saying certain things that I perhaps don't want to say"*. The Court observed that with an unrepresented party, it was questionable why so many people were considered as being needed to attend to assist and further, that although the Director-General had been introduced as simply observing the proceedings, he had actually intervened such that the Court was "surprised" such intervention had been permitted. However, whilst this was said to be an "unfortunate turn of

events", it could not be regarded as a material error of procedure.

Various other allegations were made which were largely fact specific however, the Court rejected the arguments there had been any procedural errors and dismissed the appeal against the prohibition notices.

Notice under Section 3(1)(g) of the Fiduciaries Law

The Court found similarly in respect of the decision to serve a notice on the Appellant under section 3(1)(g) of the Fiduciaries Law. The Court also briefly considered whether there were any grounds to find this particular decision was unreasonable or lacking in proportionality. The Senior Decision-Maker found that the Appellant had *"recklessly promoted a high-risk investment which was unsuitable for retail investors, and that he had dishonestly diverted payments into his personal bank account"* such that the Court found the decision to dis-apply the exemption was not disproportionate or unreasonable, it flowed naturally from the findings made and the other sanctions imposed on the Appellant. That appeal was therefore also dismissed.

Was the financial penalty appropriate?

As regards the imposition of the financial penalty of £200,000, the Statement of Reasons had set out the following:

"The maximum penalty which the Commission has power to impose under section 11D of the Financial Services Commission (Bailiwick of Guernsey) Law, 1987, is £200,000. But for that statutory cap, the Commission considers that the seriousness of Mr Merrien's conduct as recorded above, exacerbated by his failure to take responsibility for exposing clients of GIBL to undue risk in connection with a significant part of their pension portfolios, and by his failure to deal with the Commission in an open and cooperative manner in the course of these Enforcement Proceedings, would have merited a substantially higher financial penalty."

The Court held that this paragraph showed that the decision maker misdirected himself when considering his approach to the financial penalty to impose. The matters that section 11D(2) of the FSC Law required him to take into account were exhaustively listed and there was no general "catch all" permitting the GFSC to take into account any other relevant matter. The GFSC was as bound by the statutory cap as anyone else.

The Court stated that it was *"left with the impression that the GFSC has generally recognised that penalties against entities can be higher than against individuals and that the GFSC is perhaps not paying as much regard to the strictures placed on it by the legislature as it should. In particular, by having regard to the level of penalties imposed in the UK where, as I understand it, there is no statutory cap."*

As a result, the Court found this was unreasonable in the Wednesbury sense and the decision to

impose a penalty of £200,000 was an error of law, having regard to the analysis given in Walters -v- States Housing Authority

How should the GFSC approach the imposition of financial penalties?

It was held that in considering whether a person's contravention or non-fulfilment is one of the worst examples of its kind, the GFSC should adopt a similar approach to that of a sentencing court and ask whether it falls within a broad band of cases it regards as amongst the worst examples it encounters in practice. The focus should initially be on the experience of Guernsey but if it is something about which the GFSC has no prior experience, it can look to other jurisdictions but it should be only to assess whether the contravention or non-fulfilment with which it is dealing can properly be categorised in the most serious category.

The Court examined the financial penalty imposed on the Appellant and on his co-director and noted that the disparity was so great it brought into question whether the financial penalty imposed on the Appellant was disproportionate, such that this was a further reason to set the decision aside. Further, the GFSC must also have regard to the person's ability to pay the financial penalty. As the Appellant would be unable to pay, this made the level of penalty unreasonable. The matter was to be remitted to the GFSC to reconsider.

The Court of Appeal's decision

Certain parts of the Royal Court's judgment were appealed, namely: the Royal Court erred in law in its application of s11D(2) and s11D(2)(e) of the FSC Law. In particular, in deciding whether to impose a financial penalty under s11D(1) - s11D(2) did not exhaustively list the factors which the GFSC may properly take into account; and s11D(2)(e) did not require the GFSC to be satisfied that the person concerned was in a position to pay, either at all or within a reasonable time.

Counsel for the GFSC submitted that s11D(2) had to be read in conjunction with the suite of regulatory laws which conferred the powers and discretion that the GFSC is permitted to exercise to discharge its functions. It was said that s8(1) of the FSC Law set down the overarching powers of the GFSC that it *"may do anything which appears to it to be conducive to the carrying out of its functions or to be incidental to their proper discharge"*.

Further, s11D(1) of the FSC Law allowed for the imposition of financial penalties for not meeting the minimum criteria for licensing under the Regulatory Laws. S24 of the FSC Law provided that the "prescribed laws" included "the regulatory laws" which were inclusive of, but not limited to, the POI Law. The act of imposing a financial penalty was, along with other enforcement sanctions, in support of a statutory function assigned to the GFSC under any enactment which, in this case, was the FSC Law read together with the contraventions of the POI Law.

s2(4) of the FSC Law provided that:

"In the exercise of its [...] functions the Commission may take into account any matter, which it considers appropriate, but shall in particular, have regard to

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(a) [the protection of the public interest, including] the protection of the public against financial loss due to dishonesty, incompetence or malpractice by persons carrying on financial business, and (b) the protection and enhancement of the reputation of the Bailiwick as a financial centre"

The GFSC pointed out that the ellipsis in s2(4) reflected the repeal of the word "general" by s1 of the FSC (Bailiwick of Guernsey) (Amendment) Law 2002. It therefore followed that the discretion permitted by s2(4) of the FSC Law, on a proper construction, was exercisable in relation to both the GFSC's general and statutory functions.

The GFSC submitted that the overriding objectives of the GFSC as set out in s2(4) of the FSC Law had to be available to the GFSC in its operation of s11D(2), notwithstanding the lack of cross reference in the latter section. Thus in conclusion, it was submitted that in addition to being obliged to take into consideration the factors set out in s11D(2), the GFSC was entitled to take into account any other factor relevant to the decision as to whether or not to impose a penalty or as to the amount, at least insofar as the factor also bore a relationship to protection of the public interest and reputational protection for the Bailiwick.

It was then submitted that it was not a mandatory requirement that the person have the ability to pay the level of financial penalty being considered. All subsections within s11D(2) of the FSC Law were for consideration and weight should be accorded to them depending on the circumstances. In construing the statute, the canon of statutory interpretation requiring a narrow construction of penal provisions did not apply in circumstances where a competing public interest was engaged. The GFSC submitted that the approach which had been taken by the Royal Court reflected the approach taken from the criminal law as opposed to that within regulatory matters.

The Court of Appeal said that the broad question was whether, notwithstanding that the statute did not indicate that the GFSC may take into consideration any other relevant matter, the GFSC was entitled to do so (a) because of their overarching objectives under s2(4) and (b) because the considerations in s11D(2) appeared to relate to aggravating and mitigating circumstances for the person concerned. They said however, for present purposes, it was not necessary to embark upon so broad a task.

It noted it was clear that the concern of the GFSC was to be able to take into account the impact of the contravention or matter of non-fulfilment in a wide context, namely, potential impact on a wider sector of the public and potential impact on the reputation of the Bailiwick. It was held that s11D(2)(b) was expressed sufficiently widely to enable the concerns of the GFSC to be met. s11D(2)(b) indicated that the Commission must take into consideration the "seriousness of the

contravention or non-fulfilment" such that the subsection referred to the general concept of "seriousness" rather than "the financial impact" or such like. "Seriousness" therefore fell to be interpreted as "seriousness" in the context of the financial operations within the Bailiwick.

It thus held that the provisions of s11D(2)(b) were sufficiently wide to direct the GFSC to take into consideration the seriousness of the contravention or non-fulfilment in the sense of the impact on the public interest and the impact on the reputation of the Bailiwick as a financial centre.

However, the Court of Appeal clarified that it did not wholly disagree with the views expressed by the Court since (1) it was not clear that this general line of argument on statutory interpretation was before the Court and (2) the concern of the Court had arisen out of a different factual context than that being now put by the GFSC. In terms: the Court had found that the error into which the GFSC had fallen in carrying out the exercise under s11D(2) was to look to other jurisdictions for the purpose of taking into consideration the actual penalties imposed in those jurisdictions, notwithstanding that the jurisdiction in question may have had legislation which did not impose a cap but had held there was no reason why it could not look to other jurisdictions to assess whether the contravention or non-fulfilment with which it was dealing could properly be categorised in the most serious category.

The Court of Appeal therefore held that in appraising the seriousness of contravention or non-fulfilment, it was perfectly appropriate for the GFSC to look to other jurisdictions for guidance as to categorisation though they cannot be treated as precedents.

However, they held that the Court went too far in indicating that a level of penalty would be wrong in principle if it was not capable of being satisfied. On a proper reading of the section, the potential financial consequences to the person concerned and relevant third parties was merely one of a number of specified factors which the GFSC must take into consideration.

Interestingly, the GFSC submitted that whilst the imposing of a financial penalty under the statute was not designed to bring about insolvency, that did not mean a penalty could not be fixed that might have such a result. The Court of Appeal said they had difficulty with that submission: if a penalty brought about some form of insolvency, that would undoubtedly have an effect on the creditors and other third parties financially. Assuming that a penalty under the statute constituted a civil debt for which the GFSC could sue, there seemed no good reason why the States should benefit at the expense of other legitimate creditors.

Conclusion

This is another example of the sanctions imposed by the GFSC being subject to the scrutiny of the Royal Court and further, by the Court of Appeal. The following can be taken from these two judgments:

1. There is no statutory right of appeal against the publication of a statement on the GFSC's

website. That of course leaves open the possibility of bringing proceedings for judicial review of such publication;

2. Whilst the GFSC is able to have as many officers as they consider present at meetings with potential sanctionees, the Court are unlikely to be impressed with excessive attendees where there is an unrepresented party. Further, those who are stated as observers only, should remain so;

3. The starting point for the imposition of financial penalties should be comparison with other Guernsey cases. Where there are none, the GFSC can look to other jurisdictions for guidance, but only insofar as to assess levels of seriousness; of contravention or non-fulfilment – not as a direct comparator;

4. In assessing what sanctions to impose, the GFSC can take into account the impact the contravention or non-fulfilment may have on the public interest and reputation of the Bailiwick as a financial centre; and

5. If a person cannot pay a penalty, it is not wrong, in principle, to impose one. However, it is unlikely the GFSC will become a priority creditor if such person is bankrupt/becomes so as a result of the penalty.

[1] Cees Schrauwers (Chairman of the GFSC) –v- David John Merrien

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