PENALTY – penalty of £150,000 imposed by the Authority on the basis that the Applicant had received net profits from the business of £29,975 - in the First Decision in this reference the Tribunal indicated that, on the basis of its then findings, it would reduce the penalty to £70,000 – fresh evidence that the senior partner of the Applicant had also received commissions of $814,039 from the business – whether these commissions were profits of the Applicant – yes – whether the amount of the penalty should be increased from £70,000 – yes - penalty determined at £146,000. - FSMA 2000 s 206(1)

THE FINANCIAL SERVICES AND MARKETS TRIBUNAL

FOX HAYES

Applicant

- and -

THE FINANCIAL SERVICES AUTHORITY

Respondent

Tribunal : DR A N BRICE (Chairman)
MRS C E FARQUHARSON
MISS S C O'NEILL

Sitting in London on 4 February 2008

Charles Hollander QC, instructed by the Applicant, for the Applicant

Timothy Dutton QC with Richard Coleman, Counsel, instructed by the Financial Services Authority, for the Authority

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FINAL DECISION

Background

1. Between February 2003 and June 2004 Fox Hayes (the Applicant) approved a number of financial promotions for unauthorized overseas companies. The Financial Services Authority (the Authority) was of the view that the Applicant had not taken reasonable steps to ensure that the financial promotions were clear, fair and not misleading and was also of the view that the Applicant had reason to doubt that the overseas companies would deal with customers in the United Kingdom in an honest and reliable way. The Authority therefore decided to impose a penalty on the Applicant of £150,000 and gave a decision notice to that effect on 29 September 2006. The Applicant referred that decision notice to the Tribunal.

2. Before the Tribunal the Authority also argued that the Applicant had not arranged for the confirmation exercises (that the financial promotions complied with the rules) to be carried out by an individual with appropriate expertise and that the Applicant had not conducted its business with due skill, care and diligence. The Applicant disputed all the arguments of the Authority and was also of the view that the amount of the penalty was excessive.

3. Our First Decision was released on 5 October 2007. At paragraph 176 we decided:

> (1) that the Applicant did take reasonable steps to ensure that the promotions were clear, fair and not misleading;
>
> (2) that the Applicant initially did not have reason to doubt that the overseas companies would deal with customers in the United Kingdom in an honest and reliable way; however by mid-November 2003 the Applicant did have reason to doubt and, in our view, should then have ceased to act until the doubts had been removed;
>
> (3) that the Applicant did arrange for the confirmation exercises (that the promotions complied with the rules) to be carried out by an individual with appropriate expertise; and
>
> (4) that the Applicant did conduct its business with due skill, care and diligence.

4. Paragraph 61 of our First Decision set out the dates of twenty promotions approved by the Applicant of which ten were approved before November 2003 and ten after.

5. In our First Decision we also considered the amount of the penalty and whether it was excessive. We bore in mind that the Applicant did not receive the advice and help that could have been given by the Authority. We also bore in mind that, when the doubt arose, legal advice was taken by the Applicant, a meeting was arranged with the overseas companies to discuss concerns, a new code of compliance was proposed, and arrangements for the monitoring of the telephone calls made by the overseas companies

was also proposed. All these arrangements were appropriate and it was unfortunate that the meeting with the representatives of the overseas companies did not take place earlier than March 2004.

6. In the light of those findings our First Decision recorded that, in principle, we would reduce the penalty imposed by the Authority. The amount of the penalty imposed by the Authority was calculated on the basis that the Applicant had received gross profit of £178,424 from the business done for the overseas companies; that overhead costs amounted to 83.2%; that net profit was thus 16.8% of gross profit; and thus that the net profit received from this business was £29,975. We took into account the fact that the Applicant had also received £15,073.22 as interest on the monies in its client account held for the overseas companies, and, in the light of all relevant matters, we said that we would reduce the penalty from £150,000 to £70,000.

7. However, at a very late stage of the hearing the Tribunal was told that the senior partner of the Applicant (Mr Manning) had received commissions from the overseas companies. The parties were not then in a position to address us about the implications of that evidence. Accordingly, in our First Decision we stated that we deferred our final determination about the amount of the penalty until we had heard further submissions from both parties on the question as to whether the commissions should be treated as profits of the Applicant for the purpose of determining the amount of the penalty.

The legislation

8. The penalty was imposed under the provisions of section 206 of the Financial Services and Markets Act 2000 the relevant part of which provides:

> **"(1) If the Authority considers that an authorized person has contravened a requirement imposed on him by or under this Act … it may impose on him a penalty, in respect of the contravention, of such amount as it considers appropriate."**

9. The Authority has published guidance about financial penalties in *FSA Handbook, Enforcement,* Chapter 13. At 13.3.3 there is a statement of the factors which may be relevant when the Authority determines the amount of a financial penalty. These factors include the seriousness of the misconduct, the extent to which the misconduct was deliberate or reckless, the size, financial resources and other circumstances of the firm on whom the penalty is to be imposed, and the amount of profits accrued or loss avoided. Section 13.3.3 states that the Authority recognizes the need for a financial penalty to be proportionate to the nature and seriousness of the conduct in question.

The issue

10. Thus the remaining issue for determination in this reference was whether the penalty of £150,000 imposed by the Authority in 2006 was excessive.

The evidence

11. A witness statement by Mr John Robert Manning, signed on 5 November 2007, was produced. Until 14 June 2007 Mr Manning was the senior partner of the Applicant. Mr Manning did not give oral evidence at the hearing in February 2008. In deciding what weight to give to the evidence in the statement we bore in mind that Mr Manning was not questioned on it.

12. After the hearing in February 2008, and at our request, the Applicant produced its Accounts for the year ended 31 July 2005, the Annual Report and Financial Statements of Fox Hayes LLP for 2006 and 2007 and a summary of the management accounts of Fox Hayes LLP as at 31 January 2008.

The facts

The commissions

13. The facts about the commissions which were recorded in our First Decision can be summarized in this way. The financial promotions approved by the Applicant were approved between February 2003 and June 2004. In or about January 2006 the other partners of the Applicant first became aware that Mr Manning had received commissions of $518,149 between 21 May 2004 and 13 December 2004 which was 4% of the amount going through the Applicant's client account on behalf of the overseas companies after January 2003. The matter was considered by the Executive Committee of the Applicant on 30 January 2006. The Executive Committee took the view that the Applicant should have been told about the payments but accepted Mr Manning's statement that they were not partnership income for the reasons he then gave. However, in June 2007 before us Mr Manning accepted that he had not been candid with his partners in January 2006 and had misled them and had given inconsistent statements about the date upon which, and the reasons why, he had received the commissions.

14. In our First Decision we found that the commissions were paid to Mr Manning because he arranged for the Applicant to undertake the work in connection with the financial promotions. We also found that, other than the matters that were discussed in January 2006, these facts were unknown to the Applicant until the penultimate date of the hearing before us in June 2007.

15. It was common ground that the total amount of commissions paid to Mr Manning by the overseas companies amounted to $814,039, being 4% of £20,350,986.83 which was the amount that was held in the Applicant's client account for the overseas companies (see paragraph 63 of the First Decision).

The Applicant's Partnership Deed

16. Clause 18 of the Applicant's Partnership Deed provided that each partner should at all times be just and faithful to the other Partners in all matters relating to the Partnership and give a true account when reasonably required to do so by the other Partners.

The means of Mr Manning

17. We were informed that before the original hearing Mr Manning agreed with his other partners that he would indemnify them against any costs in connection with the reference and any penalty to be determined by the Tribunal.

18. The witness statement of Mr Manning described his financial position and concluded that he did not have the means to satisfy any demand for a contribution towards any fine which might be imposed upon the Applicant.

The arguments

19. For the Authority Mr Dutton argued that Mr Manning had had a duty to account to his partners for the commissions because he had made a profit by use of a fiduciary

position and the fiduciary position arose from the duty of good faith which each partner owed to the other. He cited *Regal (Hastings) Limited v Gulliver* [1967] 2 AC 134 and *John Taylors v Masons, Wilsons* [2001] EWCA Civ 2106 at [15] and [24] and also referred to section 29(1) of the Partnership Act 1890. Mr Dutton went on to argue that the amount of the commissions was relevant to the amount of the penalty because a firm should not benefit from the misconduct of a partner who failed to disclose profits; there should be an incentive to comply with regulatory standards and he referred to the *FSA Handbook, Enforcement,* Chapter 13 at 13.3.3.(4) The Applicant was the person authorized to conduct this business and the fact that the other partners of the Applicant had decided not to enforce the duty to account against Mr Manning was not relevant. He cited *James Parker v The Financial Services Authority* (2006) Tribunal Decision No**.** 037 at [158] for the principle that one purpose of a penalty was to deprive the person concerned of the profit made, or the loss avoided, by his conduct; at [167] for the principle that there should also be an additional punitive and deterrent element; and at [172] for the principle that a penalty should be proportionate to the gravity of the offence and that financial advantage was a significant factor. Mr Dutton accepted that it was work done after (and not before) November 2003 which was relevant and he suggested that the amount of commissions received after that date was 4% of $17.155m.

20. Turning to Mr Manning's means Mr Dutton argued that these were not relevant because the penalty had been imposed on the Applicant and it was the Applicant's ability to pay which was relevant. If Mr Manning's means were relevant then the Authority did not accept the evidence in the witness statement; there were no independent valuations and no documents to indicate the destination of the commissions which had been received.. Accordingly, if Mr Manning's means were relevant then the Authority made an application for a direction ordering the disclosure of the documents mentioned in a letter from the Authority dated 21 November 2007.

21. For the Applicant Mr Hollander did not dispute the legal principles relating to the fiduciary relationship between the partners as put by Mr Dutton but argued that there were understandings between the partners of the Applicant that Mr Manning would involve himself in his own business ventures and would be entitled to the benefit of them. The other partners thus consented to the variation of the usual obligations within the meaning of section 19 of the Partnership Act 1890. The best evidence of those understandings was the attitude of the other partners when they first heard about the commissions in January 2006. Turning to the amount of the penalty Mr Hollander did not accept that $17.155m had gone through the client account after November 2003 and he argued that of the twenty promotions approved by the Applicant, only ten had been approved after November 2003. He referred to the *FSA Handbook, Enforcement,* Chapter 13 at 13.3.3 and argued that, in determining the amount of the penalty it was necessary to consider all the relevant factors including the need for the penalty to be proportionate. He argued that the amount of the penalty should reflect the findings of the Tribunal in paragraph 176 of its First Decision which findings were in favour of the Applicant in respect of three out of the four matters considered and were partly in favour of the Applicant in respect of the fourth matter. He also argued that the other partners had not benefited from the commissions paid to Mr Manning.

22. Mr Hollander went on to argue that the other partners still had no intention of asking Mr Manning to account for the commissions. Although Mr Manning had agreed to indemnify the other partners in respect of any penalty determined by the Tribunal the

witness statement of Mr Manning indicated that that he would be unable to pay and so the liability would fall on the other partners who had never received the commissions. That was a matter to be borne in mind when considering whether the amount of the penalty was proportionate. If Mr Manning were to be directed to disclose documents he should be treated as a witness and the order made under rule 12(1)(b) and not under rule 10(1)(g) which applied to parties to the reference.

Reasons for Decision

23. It is not disputed that at law Mr Manning had a duty to account to his partners for the commissions because he had made a profit by the use of a fiduciary position and the fiduciary position arose from the duty of good faith which each partner owed to the other. Mr Hollander argued that the partners had consented to vary this position and that such consent was evidenced by their attitude when they first heard of the commissions in January 2006. However, we recall that Mr Manning later accepted as untrue the explanation he gave to his partners in January 2006. So, even if the other partners had consented to Mr Manning not accounting to them, such consent was given on a misunderstanding of the true position.

24. Whatever may have been the arrangements between the partners it is clear that the other partners were entitled to ask Mr Manning to account for the commissions he received and the fact that they chose not do so is not relevant. It is the Applicant which was the person authorized to undertake the business of financial promotions and the Applicant on whom the penalty is imposed. There should be no incentive for an authorized person to seek to reduce a penalty by making arrangements not to receive money that is otherwise due.

25. Accordingly we do regard the amount of the commissions as relevant in considering the amount of the penalty but, as pointed out by Mr Hollander, it is one of many factors. Another very relevant factor is that the findings in our first Decision were in favour of the Applicant in respect of three out of the four matters considered and were partly in favour of the Applicant in respect of the fourth matter. Other relevant factors are that the Applicant did not receive the advice and help that could have been given by the Authority; that, when the doubt arose, legal advice was taken, a meeting was arranged with the overseas companies to discuss concerns, a new code of compliance was proposed, and arrangements for the monitoring of the telephone calls made by the overseas companies was also proposed.

26. The Authority had imposed a penalty of £150,000 of which £29,975 related to the net profit from the business and so £120,025 represented the punitive or deterrent element. In paragraph 174 of our First Decision we said that, on the basis that the profit made by the Applicant from the work done for the overseas companies was £29,975, and that the Applicant also received £15,073.22 as interest on the monies in the deposit account, we would reduce the penalty to £70,000. Thus the amount of £70,000 we mentioned in our First Decision was made up of net profit of £29,975, deposit interest of £15,073.22 and a punitive or deterrent factor of £24,951.78.

27. Neither party put to us proposals for the revised amount of the penalty. Accordingly, we now retain the same elements as in our First Decision, namely net profit of £29,975, deposit interest of £15,073.22 and a punitive or deterrent factor of £24,951.78 making a total of £70,000 but we add an additional element representing the

commissions received by Mr Manning. We have considered whether to apportion the amount of the commissions received between those received before November 2003 and those received after that date. However, although Mr Dutton for the Authority suggested that the amount of commissions received after November 2003 was 4% of $17.155m this was not accepted by Mr Hollander for the Applicant and there was no evidence before us as to how the amount had been calculated. Mr Hollander suggested that the apportionment should be made on the basis that ten promotions had been approved before November 2003 and ten after that date but again there was no evidence before us as to how either the amount of fee income received by the Applicant or the amount of the commissions was related to the individual promotions.

28. We took account of all our findings when deciding to reduce the amount of the original penalty and so at this stage we have taken the full amount of both the fee income and the commissions. The amount of the latter was agreed at $814,039. No suggestions were put to us about the amount of the sterling equivalent and so we have used an exchange rate of 1.79 dollars per pound which rate we have derived from the "Rates of Exchange for Customs and VAT Purposes – October 2004" published by HM Revenue and Customs. This rate converts $814,039 to £454,770. This would, of course, have been received as gross profit and so we adopt the same basis as that used by the Authority to find the net profit, namely we take 16.8% of that amount. This gives a figure of £76,401.36 for net profit. If we add that figure to the amount of £70,000 mentioned in our First Decision the final figure is £146,401.36 which we round down to £146,000.

29. We do not regard the financial means of Mr Manning as being relevant to our decision and so do not make any further order for disclosure.

Decision

30. Our decision on the remaining issue in the reference is that the amount of the penalty should be reduced to £146,000.

31. Section 133(5) of the 2000 Act provides that, on determining a reference, the Tribunal must remit the matter to the Authority with such directions (if any) as the Tribunal considers appropriate for giving effect to its determination. We now remit this matter to the Authority with a direction that the penalty should be reduced to £146,000.

32. This is a unanimous decision.

DR A N BRICE

CHAIRMAN

RELEASE DATE

FIN/2006/0015
29.02.08