Introduction

When he invited me to give this lecture, your Chairman suggested that, without in any way curtailing my choice of subject, I might like to speak on the Commercial Court and its place within the judicial, legal and court system. It is a pleasure to take up that specific invitation, but I wanted to widen it slightly.

I have always taken the view that the primary function of the Commercial Court is to ensure that businesses of the City have their disputes heard as quickly, cheaply and expertly as possible. However, the Commercial Court, although the principal court which is concerned with the City, is not alone; there is the Chancery Division and there are the criminal courts whose role is sometimes forgotten. But the courts are not the only institutions that underpin the work of the City and which enable it to maintain its pre-eminence - there are two others that perform a complementary role - the auditors and the regulators.

I decided to bring auditors and regulators within the scope of this talk, because their functions closely interrelate to those of the courts in underpinning the work of the City and, as I shall endeavour to explain, it is important that they have, or should have, common characteristics in relation to the roles they perform. The characteristics I want to examine are:

- independence
- sufficiency of financial resources
- adequacy of protection from suit
- sufficiency of understanding and skill
- aufficiency of sanctions

It will, I hope, be instructive to compare the courts on the one hand and auditors and regulators on the other to see how they match up at present and how, when changes are under consideration, we should try and ensure that each retains or should attain these characteristics, as the proper operation of the court, and the auditing and regulatory systems are essential to maintaining the pre-eminence of the City and seeing that that pre-eminence is in no way damaged.

1. **The Courts**

   I turn first to the courts, both the civil and criminal courts, as the greater part of this lecture must be addressed to them.

a. Independence

   In a Code of Conduct prepared by a working party headed by Pill LJ and published this week the Judges' Council has set out the principles relating to and the real reason for independence:

   "Judicial independence is sometimes mistakenly perceived as a privilege enjoyed by judges, whereas it is in fact a cornerstone of our system of government in a democratic society and a safeguard of the freedom and rights of the citizen under the rule of law."

   I want to examine two aspects of independence – independence in the sense of impartiality and independence as a separate branch of Government.

   What I wish to say about the first aspect of judicial independence can be shortly stated, as it is self evident - the independence of the judge in relation to the specific dispute, or as it is sometimes described, "impartiality". This has occasionally given rise to problems, not least in relation to the Lloyd's litigation. However, the courts have given guidance in a number of cases and the Code of Conduct sets out in more detail the principles in relation to this and to difficult questions that can sometimes arise with regard to relationships and other activities which may give rise to perceptions of a lack of independence. These are issues that did not arise fifteen years ago, but are of increasing concern, particularly in relation to occasions when the judiciary and the profession can meet, as account has to be taken of the changing perceptions.

The second aspect of independence is more complex. A direct threat to independence from the Executive Government is difficult, presently, to conceive, despite what might appear in the press.

However, as was pointed out in the 11th F. A. Mann lecture, The Independence of the Judiciary in the 1980s, delivered by Lord Browne-Wilkinson in 1987, the independence of the judiciary was then being imperceptibly threatened by the executive's control over finance and administration because over the preceding thirty years, and in particular the preceding ten, there had been significant changes, following on from the Beeching Commission of 1969. Lord Browne-Wilkinson pointed out that Ministers had, under Treasury direction, come to control expenditure.

The assessment of need for a facility provided by the expenditure of money is not for the minister but for the judge: under our constitution, it is for the judge to determine what is just and what is not just, subject always to legislation passed by Parliament.

Judges are sitting in an environment wholly determined by executive decision in the Lord Chancellor's Department, which is in turn operating under the financial constraints and pressures imposed by the Treasury. The yard stick for decision-taking is financial value for money, not the interests of justice. What constitutes value for money is being determined by executive, not judicial decision.

Therefore the second aspect of independence which I wish to examine, is the independence that enables the court to carry out its functions, 17 years on from the time of this celebrated lecture, and consider it under the heading of the second of my characteristics - sufficiency of financial resources.

b. Sufficiency of financial resources

I need hardly point out the importance of this characteristic to those who work or appear in St. Dunstan's House, nor need I, in the light of the strenuous efforts made by the current Lord Mayor and his immediate predecessor, say anything about the importance of the Commercial Court to the work of the City.

There are two separate issues that have to be considered: (i) who is to provide the resources for justice, particularly in the context of the Commercial Court? And (ii) how is the allocation of the resources for both civil and criminal justice to be made?

i. The provision of resources by the litigant and the State

It has never been disputed that the provision of resources for criminal justice is a function of the State, though it is right to observe that the City Corporation helps with regard to the provision of criminal justice in London.

However, the position in civil justice is very different. As a result of decisions made in 1982 and 1992, it has been the policy of the Executive Government to require the civil justice system to be financed entirely from fees – the policy of full costs recovery. Justice, on the adoption of this policy, was treated as if it were a service, such as the Registry of Approved Driving Instructors or the Livestock Improvement Scheme.

The contribution made by the Treasury, under this policy, is intended to be limited to cases where the individual is, on specific grounds, such as impecuniosity, unable to afford the fee; otherwise litigants were to be expected to pay for the entire cost of civil justice.

Until relatively recently the effect of this policy was mitigated by two principal factors: first, a substantial historic subsidy from fees on the grant of probate (as the grant of probate is made by the civil courts - described once as "a small estate duty") and second, a reluctance to impose the policy in its full rigour. However, as regards the first, greater transparency of accounting has led to the progressive reduction of the subsidy from probate fees. As to the second, even greater financial control by the Treasury has resulted in the more stringent imposition of the policy of full costs recovery. The manifestation of that policy was reflected in the Consultation Paper issued in May 2004

which set out proposals to increase fees on issuing claims by significant amounts and by introducing hearing fees.

The question of who should pay for the provision of the courts for civil justice has a long history. I begins with Magna Carta, which contains a prohibition against the sale of justice. In modern times, the history begins with Bentham. As the issue is critical to the survival of local civil justice, I attempted to trace the history of dogged persistence of the Treasury in making the litigants pay for the provision of civil justice, and the relationship of that policy to the provision of local justice, in a lecture I gave at Bangor University in October 2004. That history can be summarised by saying that the Treasury tried from 1862 to impose this policy, but were resisted by Parliament (particularly in 1865 and 1884, in connection with the building of the Royal Courts of Justice) and by Lord Chancellors such as Birkenhead, Kilmuir and Gardiner. A long collective memory (conveniently wrong at times as to the previous history) and singular determination led to the Treasury's ultimate success, without any debate at all, in 1992.

I want, in this lecture, to raise the issues that relate to the Commercial Court, which, although grounded in the same basic principle as is applicable to the provision of local justice, are quite different, not the least because it cannot be said that the Commercial litigant cannot afford to contribute to the provision of civil justice. May I raise seven issues?

1. Although it cannot be said that a litigant in the Commercial Court cannot afford to make a contribution to the cost of bringing a case, why should not the State make a significant contribution, as the State has a paramount interest in providing courts in which civil disputes relating to the City can be determined? In examining this first issue, there are three principal arguments:

a. Many disputes brought are brought to resolve issues relating to the operation of the markets; their resolution assists the market and keeps the development of the law in line with emerging practice. Litigation in the courts makes public that development of the law in a way private dispute resolution cannot. Although many standard form contract disputes are resolved by arbitration, some come directly to the courts for the determination of the dispute and some come by way of appeal from arbitrations. Some reach the highest court in the UK and have the benefit of the authoritative analysis that only a Supreme Court in a major jurisdiction can give. This case-by-case development of the law is achievable only through the courts; it keeps the law up to date and provides a more certain understanding that enables contracts to be more clearly drafted and future disputes more easily avoided or resolved.
b. Development of the law is the responsibility of the State. We have no Commercial Code in this country, for reasons Lady Justice Arden explained in her Combar lecture in 1997. Despite her suggestions as to the way forward, the prospects of one being written can, I think, optimistically be described as slim. As the courts are therefore fulfilling the role of the State in developing our commercial law, why should that cost be entirely imposed on the commercial litigant in a particular dispute when he is benefiting all?
c. Law reform is also the responsibility of the State. It is the case that some areas of the law need reform that only the state can bring about, but which it declines to do. The clearest example is the Marine Insurance Act and, in particular, the law of non-disclosure and misrepresentation. Despite the recommendations of the Law Commission in 1980, and further lectures and reports since then by at least two members of the Court of Appeal, nothing has been done. The litigants have therefore had to pay for an increasing number of decisions to try and clarify the law.

2. The courts in London have to be competitive with courts in other jurisdictions. Although fees for lawyers are by far the most significant factor, surely court fees cannot be set without some regard to the position in other jurisdictions to which work might go?
3. In making the comparison with other jurisdictions, to what extent should the fact be taken into account that the judiciary are heavily reliant on the skills and ability of those who appear before them and who are paid for by the litigant? Unlike the position, for example, in the US, the judiciary have no law clerks and are much fewer in number than on the continent. The cost of providing the judiciary was and remains,as Lord Gardiner when Lord Chancellor explained to the Treasury, "dirt cheap". In this connection, it is important to emphasise that advocates of recognised experience and skill are

essential. Therefore the retention of the rank of Queen's Counsel for advocates, with the benefit of a modernised appointment process, cannot be underestimated in its importance in maintaining the position of our courts.

4. Should not the contribution that the courts make to the balance of payments be brought into account? As far as I can discern, no attention is paid to this in the financial provisions for civil justice. What rational basis can there be for excluding it?

To what extent should the Commercial litigant cross-subsidise the provision of civil justice? The point was put eloquently 125 years ago by a jurist better known for his Marine Insurance Act than for his time as a County Court Judge in the Midlands. Writing in the LQR in 1889 when he was a County Court Judge, Sir Mackenzie Chalmers, observed:

"It may be right that a court of justice should be self-supporting, but the policy of making the litigants in big towns pay the piper for country courts seems very questionable…. In Birmingham, therefore, the court fees might be reduced 50 per cent and yet the court would be self-supporting. The surplus fees from the big towns are employed in bolstering up miserable little country courts which ought, I think, to be improved out of existence."

Cannot the Commercial litigant make the same point whether he litigates in the Commercial Court or the Mercantile Court?

2. No one would contend that the Commercial litigant should not pay a reasonable amount. But is that amount to be by reference to the actual costs of the judges, staff and buildings, or by the charge of a reasonable fee, taking into account the factors to which I have referred? If it is to be the former, as is present policy, on what accounting principles are the costs to be calculated? Two items should, I think, be highlighted:

i. A capital charge is levied by the Treasury on buildings and other assets under Rules introduced in 1996 which took the place of a much more flexible regime. The objective of capital charging is to expose the cost of capital facilities for the purpose of disciplining decisions about the acquisition, use and disposal of publicly financed assets. The capital charges are calculated as the cost of the capital return on the value of the asset and a depreciation element. The asset is valued either at its Existing Use Value (something akin to market value) or its Depreciated Replacement Cost. The Depreciated Replacement Cost Value is the value of the land and the replacement cost of the building. Replacement costs of Grade 1 heritage buildings are obviously far in excess of market value, and in fact enormous. The costs that have to be recovered from litigants under the policy of full costs recovery include the amount of the capital charge. The way in which such significant assets as the Royal Courts of Justice and other significant buildings are valued for the purpose of calculating the income needed to finance civil justice, is a matter than needs to be openly understood and, if necessary, given appropriate public scrutiny.
ii. There are complex Treasury rules as to the way in which the cost of financing the building of a new court are to be treated for the purposes of accounting. These do not appear to recognise the benefits brought to the UK by the Commercial Court. However, in the light of the assurances given by the Lord Chancellor in July 2004 in relation to the Commercial Court, this may not be of pressing urgency.

7. If litigants contribute to the provision of capital assets, how is that contribution to be reflected in the accounts? If their fees have paid for an asset, are litigants to be charged again an amount to cover the capital charge on that asset? One must remember that the building of the Royal Courts of Justice was largely financed by money taken from the Suitors' Fund of the Court of Chancery, and to a lesser extent by a Treasury advance which was more than amply repaid by the fees levied in the period before the First World War. Nonetheless, the litigants have to pay for the capital charge on the Royal Courts of Justice. If they are to pay fees for future improvements in facilities or technology, are they to pay again in the form of the capital charges on those improvements?

   Some of these may seem somewhat recondite questions, and, as I have observed, court fees are not yet that significant an item in the overall costs of commercial litigation. However these issues cannot be ignored any longer:

- Fees will not remain a less important item in overall cost if the Government introduces the revised fees and, in particular, the daily hearing fee.
- Funds are urgently required to provide a proper venue for the Commercial Court.
- Funds are required for investment in IT.

The Treasury, as I have said, has secured as Government policy, the policy of full costs recovery, by dogged persistence and without any public debate. The time has now come when this must be the subject of proper enquiry and debate, not only to make local justice sustainable, but also, as I have endeavoured to show in this lecture, to secure the future of the Commercial Court.

There can be no doubt that the finances for civil justice are inadequate, and a solution to the funding has to be found. In contrast to the position of the auditor and the regulator, the position is deplorable. We cannot go on without a recognition that the State has an interest in its provision. In the context of the Commercial Court, the interest of the State is very clear because of its central role in underpinning the City.

ii. The allocation of resources
May I then turn to the second issue - the determination of the priorities for justice in the allocation of resources. In contradistinction to the issue on provision of resources, the position here has changed for the better.

There are without doubt very difficult issues:

- IT: It may be right to observe, as some do, that if Mathew J. returned to the Commercial Court Office or Chalmers to his County Court in the Midlands, neither would have seen much change to what remains a paper file based system. Partial modernisation may not help; providing email is very helpful for matters such as listing enquiries, but for filing documents it is not workable without an electronic document management system and merely puts the staff to more work and cost in printing everything out. What should we do?
- There are ever increasing demands by other areas of Justice for resources - family work and legal aid for crime being two very good examples. How is funding for civil work to be protected?

Issues relating to the priorities for expenditure are heavily influenced by the Public Service Agreement entered into between the DCA and the Treasury. This sets out objectives. Expenditure is then allocated to achieve these objectives and, to ensure that these objectives are met, more detailed targets are set for the administration. A process called "performance management" is then applied to ensure that the targets set for the administration are achieved.

But, as Lord Browne-Wilkinson observed, in his lecture, the interests of justice are involved and thus the judiciary need to be involved. It is here that a significant change has taken place since 1987. It has been accepted under the provisions of the Concordat, made between the Lord Chancellor and the Lord Chief Justice in January 2004, that arrangements will be put in place to ensure that the judiciary can be effectively involved in the resource planning of the Unified Courts Agency and the , to ensure that the judiciary is enabled to have early engagement with the new agency and Department at strategic level, including on issues concerning resource plans and bids.

The more detailed provisions of the Concordat provide for representation by the judiciary on the Boards of the Department and on the Board of the Court Services Agency and for input by the Judges' Council into the resource planning and allocation. The provisions relating to Board representation have been implemented and there has been input on resource planning. This is an aspect of the relationship partnership between the Executive and Judicial branches of government that is to be greatly welcomed. The close involvement of the judiciary in the allocation of resources should provide a much improved prospect of resources being allocated in a way better suited to the doing of justice.

These changes are encouraging. The early indications are that they are beginning to work, particularly because the DCA and its senior officials, and HCMS and its Chief Executive, have, so far, shown a determination to try and make these provisions work. There remains, however, the very real issue of the provision of the resources needed where there is an urgent need for a public re-examination of current

Treasury policy and its application.

c. The adequacy of protection from suit

There is only one word I wish to say on protection from suit. A court is dependent on fearless advocacy. Skilled and determined prosecution of offenders by the advocate for the prosecution, and firm control by the trial judge over a criminal case, are essential to ensure that dishonest conduct in the City can be deterred and punished by the criminal law.

The judge is protected from suit, and the prosecution advocate, although theoretically liable to the prosecuting authorities, is in practice immune. However, there are grounds for concern that a collateral attack can be made on this immunity through the disciplinary processes by making a complaint as to the conduct of the prosecution advocate. I mention this to highlight the importance of appreciating the dangers of such an approach. It is for the trial judge to control and deal with the conduct of the advocate, and for the appellate courts to control and deal with the judge of the lower court.

d. Sufficiency of skill and understanding

It is convenient next to turn to the need to ensure that those appointed have, for example in the case of the Commercial Court, the necessary skill and understanding of the City.

Here again there will have to be change if provisions relating to the Judicial Appointments Commission contained in the Constitutional Reform Bill become law. It would be otiose to try and improve on the arguments advanced by Combar as to the importance of this. I would therefore like to consider the mechanism by which this can be done.

The Judicial Appointments Commission will operate in much the same way as other appointment commissions or bodies; it will submit to the Lord Chancellor, through processes it will determine, the name of the best candidate for the position which needs to be filled. Currently the Lord Chancellor makes appointments to the High Court on the basis of the perceived needs of that court, but in doing so he has a great deal of flexibility, as there is a pool from which he can choose according to the specific needs, as they from time to time arise.

If, as is proposed in the Bill, the choice by the Lord Chancellor is to be restricted to a name he can accept or, with reasons, reject, then there will have to be put in place a process for determining the needs of the particular specialties in the High Court and for choosing the best candidate that meets those needs in the respective specialties. Work on this is now starting, but it is too early to say what will be done. What will be essential is to ensure that those who make the recommendation of the best candidate have sufficient knowledge of the qualities required for the specialist courts, such as the Commercial Court.

There are two other important changes that I should mention.

First, under the reforms, judicial training will become the responsibility of the Lord Chief Justice, but resources are limited for the reasons I have given. However, as regards courts such as the Commercial Court, there is also a need to keep in touch with City practice, which changes very rapidly. It is therefore of enormous importance that the Financial Markets Law Committee has agreed, and is continuing to provide seminars to the judiciary on important changes in practice.

Second, opportunities are being created below the level of the High Court for lawyers to be appointed to part time judicial posts. I very much hope that this will encourage those, particularly in City or commercial practices, who might otherwise be considering leaving legal practice in their thirties, for family or other reasons, to consider this as an alternative. I do not see why in the future persons appointed to such positions cannot, when circumstances permit, take more senior and full time positions. I would encourage commercial chambers and City firms to do all they can to support these new opportunities.

e. The sufficiency of sanctions

So far, I have concentrated what I have to say on civil justice. In respect of the sufficiency of remedies and sanctions, there is little to say in relation to civil justice - the civil courts have adapted remedies to meet the needs of commerce. However, the City is also underpinned by the in respect of criminal justice. There is again a real concern about the efficacy of the criminal courts in dealing with financial crime and it is to that topic I now wish to turn.

Some years ago there was concern about the ability of the criminal courts to try a case involving financial crime because of the perceived difficulty in explaining the commercial background to a judge and jury. A number of steps were taken which should have addressed this issue; can I take three examples?

1. The training of prosecution advocates and judges so that they can properly understand financial transactions. Judges trying these cases are now specifically authorised.
2. The improvements in the presentation of evidence using information technology.
3. The change in the composition of juries, consequent upon the legislation brought into effect in April 2004.

However, the fact is that trials for cases involving financial crime are taking much longer - in some instances over a year. The cost of such cases is now so high that the question is again being asked as to whether a criminalrial trial can be justified for many types of financial crime and whether it would not be better to use the regulatory system.

I will address the question of using regulatory sanctions for financial crime instead of the criminal courts when I come to consider the role of the regulator in underpinning the City, but I should state that I consider that any such change is wholly unnecessary, because there are at least two steps that should be taken immediately and, if necessary, a third could then be implemented:

1. One of the major causes of the present problem is what has happened on disclosure. The position is much worse than it ever was in the civil courts when Peruvian Guano represented the law. Now is not the time to address the various solutions that are needed, but a radical solution to the problems caused by disclosure must be the first step.
2. The second step must be more rigorous control over the criminal trial to ensure that the process is proportionate to the matters in issue. This kind of case and trial management has long existed in the Commercial Court and more recently in all the civil courts. It is essential that we find a means of identifying the issues in a criminal trial as early as possible and ensuring that the trial focuses on those issues. For example, there is no reason why most points of law cannot be dealt with by proper skeletons with the economy of oral advocacy that is to be found in the civil courts. Recent experience has shown that where these techniques are applied, then criminal trials can be shortened dramatically.

If such steps do not succeed, then consideration must be given to a third step - the implementation of s. 43 of the Criminal Justice Act 2003 to institute trial by judge alone - before any consideration is given to removing financial fraud from the criminal courts. Trial by judge alone is not a subject I can begin to address in this lecture.

2. **The regulator and the auditor**

I would like to take the auditor and the regulator together. It may not, at first sight, be apposite to refer to the auditor as an institution, as the function of auditing is performed by private firms. However, the function of auditing is an institutional one; the fact that it is performed by private firms does not affect its functional character any more than the fact that some prisons are run by private companies does not change in any way the characteristic of the prison as a penal institution.

a. Independence and adequacy of protection from suit

No issue arises as regards the regulator; it is accepted that the regulator must be independent of those regulated. The concept of independence, in the sense of impartiality, may not be that different to that first aspect of concept of the independence of the judge, though as regards the second - the

independence as a separate branch of government - the position is quite different. Independence, in its first sense of impartiality, is buttressed by structures and arrangements that ensure independence. As a consequence of such independence, a regulator such as the FSA is properly entitled to immunity to claims for damages, save where there is bad faith or a breach of the Human Rights Act.

But the position is very different as regards the auditor.

Auditing is a term now widely used for an independent verification of whether the performance of a body accords with the performance to be expected of it, or which it has claimed. Its essence is the independence of that verification. Under the Companies Act 1985, the auditor of a company is required to express a view on the truth and fairness of the accounts in the respects specified; he is given statutory powers of access to the books, and the right to require information to be provided. However, no direct provision is made for his independence, save that he is not to be an employee of the company and must be a member of one of the recognised accounting bodies; these bodies are required to have rules relating to professional integrity and independence.

During the 1980s and the 1990s the size of the main firms of accountants expanded. Firms obtained an increasingly larger amount of non-audit work from companies they audited – work which in many cases became more valuable in terms of fee income than audit work.

When I was an Inspector into the affairs of Mirror Group Newspapers, it was striking, as the Report I wrote with my co-Inspector shows, how firms had changed since the late 1960s and early 1970s when the companies then controlled by the late Mr Robert Maxwell were the subject of an earlier Companies Act Inspection. The resulting pressures are evident from the factual account contained in the Report, published in 2001.

As Inspectors, we set out our view of the need for more radical thought and wider debate on the issue of auditor independence in the UK. We did so because of the conclusions we reached about the relationship between the auditors and the companies controlled by the late Mr Maxwell. It was neither the Report nor our views that prompted action; rather it was Enron and related matters.

Consideration was then given to the issue by various bodies, including most importantly a Coordinating Group on Audit and Accounting Issues, whose Report was published on 29 January 2003. A statement was made to the House of Commons on the same day by the Secretary of State. In the Report's chapter on Auditor Independence, it was acknowledged that company audit was a fundamental part of the framework which supported the capital markets and company reporting more generally. The Report's view of auditor independence was:

"Auditor independence starts with the question of whether the auditor acted in an independent manner as a matter of fact. But for the most part, this cannot be verified since it relates to the state of mind of the auditor at the time. So perceptions are important too; it is important for public policy not only that an auditor acts independently, but is perceived to do so. Independence in appearance is most commonly defined in terms of what a reasonable and well informed person would judge to be independent, after taking into account all the circumstances and relationships which exist between the auditor and the audit client."

A package of measures was put forward including audit partner rotation and the need for tougher and clearer safeguards to ensure that joint provision of audit and non-audit services did not undermine independence or the appearance of it. Other measures which were suggested included disclosure, and steps that would ensure that firms were alert to the threats to their independence arsing from fear of losing an economically significant client.

The proposals in the Report were welcomed by the Secretary of State who announced that, as much of what had been recommended had been adopted voluntarily by the profession, the Government was content to see if this voluntary basis worked; if it did not, there would be legislation. As was clear from the debate that followed, the Government believed that the measures achieved the right balance to ensure independence. Strengthening of the professional rules was the result.

There then followed, in December 2003, a DTI consultative paper on Directors' and Auditors' Liability in relation to the recommendations of the Company Law Review, and to the proposals put forward by the largest firms of accountants for a cap on their liabilities as auditors. Among the arguments made by the largest firms was that, as the market for those able to provide audit services was limited and might decline further, a cap would help competition. In August 2004, the Office of Fair Trading set out its view that a cap would not be pro-competitive. The debate on this work continues.

However, it seems to me that, in this debate, the linkage of some exemption from liability, and the necessity for independence – in the sense of impartiality akin to that of the regulator and the courts - is fundamental.

First must be the issue of principle. Is it possible to come to any other conclusion, as a matter of principle, than that the only tenable solution is a statutory prohibition of an auditor of a public company performing non-audit work for the company he audits? This conclusion plainly follows as a matter of principle, because the office of an auditor requires him to express his independent expert opinion on the truth and fairness of accounts. That opinion will be directly relied upon by many and will have an indirect effect on many others. Not only does the auditor have to be independent, but he has to be seen to be independent.

Outside the field of audit work, it would be inconceivable, as a matter of principle, that such a person could be doing other paid work for the person about whom he was expressing an independent opinion. Not only do firms of accountants work in that way when acting as auditors, but they may also in the course of an audit express an independent opinion on matters which might include work which others within the same firm have carried out. No person could, for example, be seen to be independent, as an expert or an arbitrator, if his firm carried out other paid work for the person about whom he was expressing opinion, let alone express an opinion on work his firm may have done.

The response made to the application of these incontrovertible principles to the role of accountants in auditing is that there are practical advantages that necessitate the special rule for accountants when acting as auditors. But the pragmatic question must then be asked as to the extent to which the realities of modern business and commerce make it increasingly difficult in practice to ensure that pressures that compromise independence are not applied. That must be in the end for the Government and the professional bodies to judge, but in so doing they should take into account the parallels that I have sought to draw.

Furthermore, the issues of independence and protection from suit are plainly interdependent. If an accountant acting as auditor does not in fact enjoy independence and the perception of independence, then it is difficult to see how it can be right that he is entitled to any limitation of liability; the sanction of unlimited liability must surely be needed. However, if an auditor is truly independent in the sense I have identified, then it seems to me that there can be no objection in principle to an auditor enjoying some measure of protection and certainly a limit to his liability. But such protection must be conditional upon true independence.

0. (b) Sufficiency of financial resources

As regulators and auditors are not financed by the State, there are no resource difficulties. The contrast with the courts is obvious to any person accustomed to the facilities available to auditors and regulators. I need say no more than to mention St Dunstan's House and Canary Wharf.

But there is a word I would like to add about auditors. It might be said that a blanket prohibition might increase the cost of an audit, but this then gives rise to the second of the characteristics I have identified - the adequacy of the resources to enable the auditor to perform his function. I accept that there may be an increase in the cost of an audit by imposing the change that both principle and pragmatism appear to demand. This is because it would remove any cross-subsidy provided by non-audit work and require the independent auditor to spend more time reviewing non-audit work done by another firm in its capacity as accountants advising the company. It would also mean that advice on tax and other matters had to be separately sought. But the fact that such costs might arise, if a

change were made, might be said to highlight the lack of independence in the present arrangements. For example, if a transaction has been carried out on the basis of advice by the audit firm, then it should be examined independently by another firm for the purpose of the statutory responsibilities in the audit. It is difficult to see how the same firm can advise on how a transaction should be structured and then express a view on truth and fairness of accounts in which that transaction is reflected, if that view is to be properly characterised as independent.

0. (d) Sufficiency of skills and understanding
   It is essential that those who work for auditors and regulators have a proper and up-to-date understanding of the markets in which they operate; in this respect, their position is similar to that of the Commercial Judge, but even more so. They need to attract the ablest people, and careers must be structured to enable this to happen, just as, in a different way, a new opportunity is being created for part time working in the judiciary.
a. (e) Sufficiency of sanctions

As to auditors, it seems to me that the public sanction of an adverse audit report, and the provisions in relation to "whistle blowing", are adequate.

However, as regards sanctions, the position of the Regulator, in contradistinction to the court, needs to be considered. It is important to establish clearly what is apposite for regulation and what for the criminal courts.

There is no doubt that regulatory sanctions can have a severe effect; an adverse finding can destroy reputation, a fine can be financially ruinous and a person's ability to earn his living in his trade or profession can be removed. However, it seems to me important to distinguish between conduct that is apposite solely for regulatory sanctions, and conduct for which it is necessary for the perpetrator to be punished with the sanctions that only a criminal court can impose. The dividing line must generally come where dishonest conduct has caused loss, or enabled the perpetrator to make gains. It is this type of dishonest conduct that has generally been understood to be the province of the criminal law and not the regulator.

Nonetheless, it has from time to time been suggested that dishonest conduct that causes loss or brings about gain should be dealt with by the regulatory system rather than the criminal courts. The principal rationale is that regulatory tribunals would be quicker and hence cheaper. Such a suggestion is again being mooted, as I have mentioned. There are however powerful factors against that view.

In the first place, is it not in accordance with generally accepted principles that dishonest conduct that has caused loss or conferred gain should be adjudicated on and punished by the criminal courts?

Secondly, is not the deterrent effect of imprisonment substantial? Probably the most significant criminal trials relating to the City in the period between the First and Second World Wars was the trial at the Old Bailey of Lord Kylsant and Mr Morland, a partner in Price Waterhouse between 20 and 30 July 1931. Kylsant was charged with issuing a balance sheet calculated to deceive shareholders, and members of the public considering buying shares, in relation to the financial condition of the Royal Mail Steam Packet Company of which he was chairman. In essence, the company was trading at a loss, but had been paying dividends from hidden reserves for a period of six years. Morland was acquitted, but Kylsant convicted and sentenced to one year's imprisonment. His appeal against conviction was dismissed and he was refused leave to appeal against sentence. The importance of this case lies not so much in the fact that it was possible at that time to try a case of this kind in nine days, but in the impact the trial and sentence had in the City. Many years later it was recalled as an event that had sent out a significant message to practitioners that imprisonment was a likely consequence of dishonesty. My own experience, whilst a practitioner, of dealing with dishonest conduct in the City was that the sanctions open to a regulator were not sufficient. As the late Armand Hammer, one of the most interesting businessmen of the twentieth century put it: "Reputation has its price". Experience has shown that, after a short while, people will do business with the person who has merely been the subject of regulatory sanctions. It is still not difficult to conceal significant funds so that they cannot be traced. Despite the significant change brought about after September 11,

concealment of the proceeds of financial fraud is not difficult. Nor, in my own experience, is it difficult for someone barred from a profession or trade still to carry it on through others. In short, the sanction of imprisonment remains by far the most potent.

But there is a third and even more potent reason. It cannot be just to imprison someone who gains by a fraud which it is easy to prosecute, and yet not prosecute another because it is expensive or difficult. If this were the touchstone for prosecution, then those who defrauded the Department of Health and Social Security of £30,000 by a benefit fraud would go to prison, whilst someone who committed a fraud of some complexity in the City and obtained 10 or 20 times that amount would not, even though he had probably done far more harm. Merely to make this obvious point shows the injustice of any proposal to impose a regulatory sanction for a crime of dishonesty simply because it may be expensive to prosecute. It would rightly be seen as one law for white collar criminals and another law for the rest.

Thus when it is suggested that the regulatory regime is apposite for City criminals who defraud others of sums which may be less than the cost of prosecuting them in the way we currently do, then the answer must be first, to take the two steps I have suggested to reform our procedure for criminal trials, and, if such steps do not make a sufficient difference, then there is the third step to which I have referred - the removal of trial by jury in such cases. This must be preferable to creating a regime that will not only provide a lesser penalty, but in the process is likely to do grave damage to the City and its international standing. The sanction of imprisonment remains the most effective deterrent.

Both the Runciman Commission and Auld LJ took the view that only financial and market infringements should be removed from the criminal courts. As Auld LJ observed in his Report:

"Close attention needs to be paid to the widely expressed concern that it would enable the rich, but not the poor, to buy their way out of prosecution."

There is one other issue to consider about the sufficiency of sanctions - the relationship of financial penalties imposed by the regulator, and those imposed by the criminal courts. Regulators are now imposing severe financial penalties for misconduct which is negligent or in breach of regulation or statute and results in financial damage. The size of these financial penalties must be contrasted with the much lower financial penalties imposed by the courts for conduct which has the similarity of being negligent or in breach of statutory duty, but which is strikingly different in that it results in death or serious injury and is properly characterised as criminal. I do not wish to say more than that there must be some rational equation between the two. I would hope that in due course the Sentencing Guidelines Council can find a way of assisting on this. We cannot have a regime where greater penalties are imposed for breaches that result in financial loss than breaches that result in death.

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Conclusion

I have endeavoured to show in this lecture that there are common characteristics and common standards between the Courts, regulators and auditors, which do in fact exist and, where they do not exist, should, exist. There are some stark contrasts, but I would hope that by examining courts, auditors and regulators together, the changes that are necessary or being debated in respect of each can take into account their complementary roles and the necessity for them to enjoy similar characteristics.

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Footnote 8: The agreement entered into in 2004 provides in respect of civil justice:

Objective II: To ensure that the public, especially the socially excluded and vulnerable, have access to excellent services, which enable them to exercise their rights in law and understand, exercise and fulfil their responsibilities.

4. By 2009-10, increase the proportion of care cases being completed in the courts within 40 weeks by 10%.
5. To achieve earlier and more proportionate resolution of legal problems and disputes by:
   - increasing advice and assistance to help people resolve their disputes earlier and more effectively;
   - increasing the opportunities for people involved in court cases to settle their disputes out of court; and
   - reducing delays in resolving those disputes that need to be decided by the courts.

These agreements are supported by technical notes:

The PSA will be achieved if the following three elements are met by March 2008:

- to achieve a 5% increase in the proportion of justiciable problems in respect of which people receive suitable advice and assistance;
- to reduce by 5% the proportion of disputed claims in the courts that are ultimately resolved by a hearing;
- to increase by 2% the number of Small Claim cases that are heard within target time.

Footnote 9: Paragraph 20.

Footnote 10: It is clear that the achievement of targets in the current regime of Treasury funding is important and seen to be important by those who have to account to the Treasury. It is, in current circumstances, impossible to ignore this. Therefore the Judiciary decided, after consideration of the issues by a working party under Etherton J earlier this year, to engage in discussion with the representatives of the Executive to try and prevent the setting of inappropriate targets, and to try to ensure that the targets which are set are not such as to interfere with judicial independence in the carrying out of judicial functions. This approach is not inconsistent with the independence of the judiciary; after all the Commercial Court has its own self-imposed targets of the dates by which it will ensure that the trial takes place and publishes that on the web.

Footnote 11: Paragraph 19 of Schedule 1 to the Financial Services and Markets Act 2000.

Footnote 12: s. 235.

Footnote 13: s.389A.

Footnote 14: s. 389.

Footnote 15: Paragraph 7 of Schedule 11 of the 1989 Act.

Footnote 16:

1. The body must have adequate rules and practices designed to ensure:
   a. that company audit work is conducted properly with integrity, and
   b. that persons are not appointed company auditor in circumstances in which they have any interest likely to conflict with the proper conduct of the audit.
2. The body must have adequate rules and practices designed to ensure that no firm is eligible under its rules for appointment as a company auditor unless the firm has arrangements to prevent:
   a. individuals who do not hold an appropriate qualification, and
   b. persons who are not members of the firm

   from being able to exert any influence over the way in which an audit is conducted in circumstances in which that influence would be likely to affect the independence or integrity of the audit.

Footnote 17: Paragraph 23.62.

Footnote 18: Paragraph 22.9.

Footnote 19: An excellent account is given by Lord Devlin in chapter 12 of his partial autobiography: Taken at the Flood (London 1996).

Footnote 20: (1931) 23 Cr. App. Rep. 83.

Footnote 21: Chapter 9, paragraphs 48-51.

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