UPDATE

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Courts will apply greater scrutiny to regulatory penalties

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On 11 May 2016, the Royal Court of Guernsey allowed in part an appeal from a decision by the Guernsey Financial Services Commission (the GFSC) to impose sanctions for breaches of various regulatory laws, including the Protection of Investors (Bailiwick of Guernsey) Law, 1987 (the POI Law). In doing so the Court made a number of useful observations on the enforcement process of the GFSC and the scrutiny to which it should be subjected.

On 11 May 2016[1] the Royal Court of Guernsey allowed in part an appeal from a decision by the Guernsey Financial Services Commission (the **GFSC**) to impose sanctions for breaches of various regulatory laws, including the Protection of Investors (Bailiwick of Guernsey) Law, 1987 (the **POI Law**). In doing so the Court made a number of useful observations on the enforcement process of the GFSC and the scrutiny to which it should be subjected.

Background

The Appellants were a Company and its three directors. The GFSC had imposed sanctions on them under the full suite of Guernsey's regulatory laws, including the POI Law, the Regulation of the Fiduciaries, Administration Businesses and Company Directors, etc (Bailiwick of the Guernsey) Law 2000 (the **Fiduciaries Law**) and the Financial Services Commission (Bailiwick of Guernsey) Law (the **FSC Law**) (the **Decision**). The Decision followed findings of various breaches of the regulatory laws arising from the administration of a Guernsey company connected to the Arch Cru investment fund. The investor losses arising from Arch Cru and its related investment vehicles are well known. It led to the GFSC investigation of the Appellants and ultimately, the Decision.

The author of the Decision was an English QC – with expertise in regulatory matters – who had delegated authority to determine what sanctions should be imposed (the **Decision-Maker**). The Decision imposed prohibition orders of five years for each director, financial penalties for each director and a financial penalty of £150,000 against the Company. It also directed that a public statement be made pursuant to the Financial Services Commission (Bailiwick of Guernsey) Law, 1987.

Following receipt of a notice of intended decision by the Decision-Maker (the **Minded To Notice**), the Appellants made various submissions similar to those which formed the grounds of their appeal (see below). This resulted in the prohibition orders for two of the three directors being reduced from fifteen years to five years. However, in respect of the third director, whilst the Minded To Notice had proposed a prohibition order of five years, the Decision included the same sanction. Similarly, there was no reduction in the financial penalty for the Company.

[1] *Bordeaux Services (Guernsey) Limited & Ors v The Guernsey Financial Services Commission* (dated 11 May 2016 – unreported)

The Appeal

The three directors accepted that some penalty was appropriate, and did not challenge the financial penalties against them. The appeal was confined to the length of the prohibition orders and the amount of the financial penalty against the Company. The Appellants contended that not only had the Decision-Maker erred in law, but the sanctions were disproportionate and/or unreasonable. Importantly, the Decision did not contain any finding of dishonesty or market abuse. In addition, the GFSC had failed to demonstrate that the Appellants' conduct had caused any loss to investors. The GFSC's practice in past cases also demonstrated that the sanctions were disproportionate, and the Decision did not appear to take into account the potential financial consequences for the Company by imposing a penalty of £150,000. That level of penalty was at the upper end of the range of financial penalties (the statutory maximum at the relevant time was £200,000).

The Court accepted that the Decision was to be subject to a higher level of intensity when it was conducting a review, particularly because the availability of discretionary penalties meant the process was 'quasi-criminal'. The appointment of Queen's Counsel from other jurisdictions also meant that the Decision should 'bear the hallmarks of fairly closely reasoned decisions at, or approaching, the style of decision that would be expected from a judicial tribunal'.

The Court also accepted that guidance from the Privy Council on unreasonableness and proportionality in *Gokool v Permanent Secretary of the Ministry of Health and Quality of Life* [2008] UKPC 54 applied in Guernsey. It involved consideration of whether the Decision-Maker had given 'disproportionate weight to one or more of the considerations relevant to his Decision, and if so whether it is of such significance that the aspect of the Decision affected falls outside the range of reasonable responses that could follow in the circumstances of the case'. The review was less about the process and more about the outcome.

It was incumbent upon the GFSC to explain its reasoning in coming to a decision about the length of prohibition orders which should be imposed. The Court was unable to identify any reason why the periods in respect of two of the three directors had been reduced in the Decision from those orders proposed in the Minded To Notice, but no reduction had been applied to the third director. It was appropriate either to expect some reduction, or an explanation as to why it had been decided that each director should face the same length of prohibition.

Whilst it had been right for the Decision-Maker to impose prohibition orders, the 'absence of any rational explanation' led the Court to determine that the prohibition order imposed on the third director was disproportionate and should be set aside. The matter was remitted to the GFSC to re-consider the appropriate length of the prohibition order to be made against that director and the reasoning behind that decision. Otherwise, the five year prohibition orders imposed on the other two directors, whilst 'at or very near the upper limit of what is reasonable and proportionate' would not be interfered with.

The financial penalty imposed on the Company was also found to be unreasonable and disproportionate, particularly having regard to the potential financial consequences to the Company. Whilst there had been various failings under the applicable regulatory laws, the fact the Decision was silent as to how the Commission took into account penalties which it had imposed in past cases was 'troubling'. In addition, the 'paucity of reasoning' relating to the financial penalty imposed on the Company and why that penalty was unchanged from the Minded To Notice all pointed to the financial penalty against the Company being higher than it should be. That matter was also remitted to the GFSC to re-consider the amount of the financial penalty to be imposed, with full reasoning given as to the level of the penalty.

Finally, the Decision did not contain any reasoning as to why the sanctions were to be imposed against the directors under other of the applicable regulatory laws. Though it would only have required a paragraph or two to read across the same reasoning as applied to the POI Law and the Fiduciaries Law, the absence of that was fatal and the sanctions under the laws other than the POI Law and the Fiduciaries Law were set aside.

Conclusion

The judgment demonstrates that decisions of the GFSC will be subject to a high degree of judicial scrutiny on appeal. It is also a salient reminder of the need to engage in the enforcement process carefully and robustly from its outset until its conclusion.

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[Document Reference]

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