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Litigation & Arbitration Group Client Alert: FCA Publishes Decision to Fine and Ban Former Non-Executive Director for Failing to Disclose Conflicts of Interest

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CONTACT

Charles Evans
Partner
+44 20 7615 3090
cevans@milbank.com

The Financial Conduct Authority ("FCA") has published a decision notice dated 28 November 2012 which its predecessor, the Financial Services Authority ("FSA"), had issued to Angela Burns, a former non-executive director of two mutual societies. In the decision notice, the FSA concluded that Ms. Burns had failed to disclose certain conflicts of interest in breach of her obligations under Statement of Principle 1[1]. The FSA imposed a fine of £154,800 and banned her from performing any future role in regulated financial services. Ms. Burns has referred the decision notice to the Upper Tribunal.

This is the first time the FCA (or its predecessor) has sought to impose such a severe sanction on a non-executive director for non-disclosure of conflicts of interest. The decision notice serves as a timely reminder to all directors, both executive and non-executive, to ensure that they disclose such interests - if there is any doubt, the clear message is to disclose.

BACKGROUND

Ms. Burns was an "experienced professional in the UK investment industry" and the chief executive of her own investment consultancy business. In 2006, having provided some consultancy advice to an investment manager (the "Investment Manager"), she asked the Investment Manager for the opportunity to turn her proposal into a UK business; however, the Investment Manager declined to pursue this proposal.

By 2008 the Investment Manager had decided to enter the UK market and Ms. Burns submitted a formal proposal outlining the work which she could perform for the Investment Manager which included "gathering" assets in the institutional sector and providing non-executive services.

Ms. Burns was appointed a non-executive director and approved to perform the CF2 role of Marine and General Mutual Life Assurance Society ("MGM") in January 2010 and of Teachers Provident Society ("Teachers") in May 2010. She was chair of each society's investment committee.

[1] An approved person must act with integrity in carrying out his controlled function.

MGM

Following her appointment as a non-executive director, Ms. Burns informed a number of her contacts at the Investment Manager of her new role and re-sent them her 2008 proposal. At her first MGM board meeting, Ms. Burns recommended that the board should consider using the Investment Manager to manage a portfolio of assets. Although the MGM board was aware that Ms. Burns had done a consulting project for the Investment Manager in the past, she did not disclose that she was seeking consulting work from the Investment Manager. In fact, in early 2009, she had told the MGM CEO that there was no prospect of her working with the Investment Manager. However, in subsequent emails with the Investment Manager, Ms. Burns sought to perform consultancy work for the Investment Manager and to serve as a non-executive director for the Investment Manager's Dublin funds.

In September 2009, MGM's investment committee approved the recommendation to place a £350 million mandate with the Investment Manager.

Teachers

Following her appointment as a non-executive director, Ms. Burns recommended that the Investment Manager be included in the tender process which Teachers was running to select a new investment manager. By November 2010, Teachers considered the Investment Manager to be the preferred candidate for the investment mandate of c.£750m. However, on 5 November, before the Investment Manager made its tender presentation, Ms. Burns sent an email to the Investment Manager. The Investment Manager considered the email to be a request for payment and a non-executive director role in return for Ms. Burns using her position at MGM and Teachers to facilitate the placement of investment mandates at those firms with the Investment Manager. The Investment Manager rejected this request and decided to withdraw from the tender process.

Again, the Teachers board was aware that Ms. Burns had done consultancy work for the Investment Manager in the past, but at no point did she disclose that she was seeking work from the Investment Manager.

In her representations, Ms. Burns had argued, amongst other things, that no discloseable interest had crystallised since there was "no traction" in her discussions with the Investment Manager and her approaches were no more than "feelers". She accepted that the 5 November email was poorly worded but she claimed that it was no more than an attempt to resurrect or re-invigorate the discussions for future work set out in her 2008 proposal.

BREACHES

The FSA concluded that Ms. Burns had:

- failed to act with integrity in breach of Statement of Principle 1 by failing to disclose her conflicts of interest to MGM and to Teachers and by attempting to use her fiduciary position as a non-executive director of both MGM and Teachers to benefit herself;
- disregarded her duties under the relevant companies legislation[2], articles of association and conflicts documentation to declare her interest in obtaining work for the Investment Manager; and
- breached her fiduciary position of trust when she had told MGM's CEO that she had no prospect of working with the Investment Manager at a time when she was trying to obtain work from it.

SANCTION

The FSA imposed a prohibition order on Ms. Burns banning her from carrying out any function in relation to any regulated activity.

It also imposed a fine of £154,800. Since the relevant conduct took place both before and after 6 March 2010 (when the FSA introduced a new penalty regime), the fine was calculated in two parts. Under the old regime, a figure of £75,000 was determined to be the appropriate sum. Under the new regime, having identified Ms. Burns' relevant income (£66,500), the FSA considered the seriousness of the breach and determined that this was a level 4 (out of 5) case – meaning the appropriate percentage to apply to the income figure was 30%. The resulting figure (£19,950) was deemed too small to act as a deterrent and was adjusted upwards by a factor of 4. In a stark warning to others, the FSA noted that the multiple may be higher for those not heeding the lessons of this notice.

COMMENTS

Conflicts of interest

The notice provides a salutary lesson of the importance of identifying conflicts of interest and making appropriate disclosure of them. This is particularly true of non-executive directors who "are more likely to have a portfolio of appointments and are likely to find themselves having to manage conflicts of interest more frequently than their fellow directors."[3]

[2] In relation to MGM, section 177 of the Companies Act 2006 and in relation to Teachers, section 63 of the Building Societies Act 1986 which is extended to the Friendly Societies Act 1992.
[3] FCA press release dated 24 May 2013

The FSA rejected Ms. Burns' argument that no discloseable interest had crystallised because the discussions were at a preliminary stage. It concluded that her interest in the discussions was still very real and substantial. The FSA also rejected the suggestion that there was a difference between an actual and potential conflict adopting the Upper Tribunal's analysis in First Financial Advisers Ltd v the FSA[4]:

> *" If the use of "potential" is intended to denote a circumstance where a person may become entitled to receive benefit from an interest that could be in conflict with a duty, but at the material time there has been no such receipt, then that in our judgment is a real and present conflict, notwithstanding that the benefit has not crystallised, or indeed may never do so."*

Ms. Burns' argument that, in practice, difficult judgement calls were required to be made was not accepted not least because there was no evidence that she had discussed her position with anyone else.

The FSA's view is clear: if there is any doubt at all, it is better to disclose: "A disclosure gives the other person a choice. No disclosure denies that person the opportunity of coming to a view on a matter which is of interest to them." [5]

Lack of integrity

Although Ms. Burns had not acted deliberately or dishonestly, the FSA concluded that she lacked integrity. This may seem surprising, given that honesty is a concept usually associated with integrity. Indeed, all the examples of conduct which does not comply with Statement of Principle 1 cited in APER 4.1 refer to deliberate or dishonest conduct (including the deliberate failure to disclose the existence of a conflict of interest in connection with dealings with a client). Most of the cases involving a breach of Principle 1 involve deliberate and intentional misconduct but there are cases where individuals have been found to lack integrity on the basis of reckless conduct. For example, in 2009, the Tribunal found Milan Vukelic lacked integrity "in that he must have turned a blind eye to the obvious". He was reckless rather then negligent because he had reason to believe that the transaction in which he was involved was improper but it appears from a final notice issued to James Shanks[6] that negligence (in that case, failing to check information in circumstances where it would have been easy to do so) was sufficient to ground a finding of lack of integrity.

Publication of the decision notice

Ms. Burns applied unsuccessfully to the Upper Tribunal for an order[7], amongst other things, prohibiting publication of the decision notice.

In its judgment, the Tribunal followed the approach which it had set out in Arch Financial Products and Others v FSA[8]. It stated that there is a presumption[9] that

[4] FS/2010/0038
[5] Paragraph 7.12
[6] Final notice dated 18 December 2009
[7] Under Rule 14(1) of the Tribunal Procedure (Upper Tribunal) Rules 2008

publicity will be the norm. The exercise of the power to prohibit publication is a matter of judicial discretion which should be exercised taking into account all relevant factors and giving effect to the overriding objective that requires the Tribunal to deal with cases fairly and justly. This involves a balancing exercise but there is a strong presumption in favour of open justice which may be rebutted by "cogent evidence" of a "disproportionate level of damage".

Ms. Burns argued that if the decision notice was published it would destroy her livelihood. Whilst the Tribunal accepted that destruction or serious damage to livelihood is at a higher level than embarrassment or reputational damage, some damage is to be tolerated because of the importance of the open justice principle. Publication should be prohibited where the impact of publication on the individual is so severe that it outweighs that principle. It was necessary to establish that there was a serious likelihood of destruction or damage to livelihood occurring. In relation to Ms. Burns, the Tribunal found that:

- There was a significant possibility, but not a serious likelihood, that Ms Burns' one client would terminate its contract if it learned of the decision notice but there was also a significant possibility, given the current level of activity under the contract, that the client would terminate the contract in any event.
- There was no certainty that Ms. Burns regardless of publication would be in a position to secure other work over the next year.
- In the worst case scenario, if publication took place, the client may terminate its contract with her but she would not be destitute as she had other assets to fall back on.
- If Ms. Burns' reference to the Upper Tribunal was successful, there would be a reasonable prospect of her being considered for further work from previous clients and contacts. Consequently, the overall result would be that her consultancy business would be put on hold while she pursued the reference.
- There are no other individuals, such as employees, whose position would be adversely affected by publication.

Accordingly, the Tribunal concluded that any damage to Ms. Burns' livelihood caused by publication was not so severe that it outweighed the public interest in the principle of open justice. However, the Tribunal did give Ms. Burns the opportunity of discussing the proceedings against her with her existing clients and contacts as a way of minimising the impact of publication. The Tribunal also directed the FCA to make clear when it published the decision notice that it was subject to challenge and its findings were provisional.

[8] FS/2012/20

[9] Under section 391 of the Financial Services and Markets Act 2000

Milbank

LONDON
10 Gresham Street, London EC2V 7JD, England

Tom Canning	tcanning@milbank.com	+44-20-7615-3047
Charles Evans	cevans@milbank.com	+44-20-7615-3090
Julian Stait	jstait@milbank.com	+44-20-7615-3005

NEW YORK
One Chase Manhattan Plaza, New York, NY 10005

Wayne M. Aaron	waaron@milbank.com	+1-212-530-5284
Thomas A. Arena	tarena@milbank.com	+1-212-530-5828
Sander Bak	sbak@milbank.com	+1-212-530-5125
James N. Benedict *Chair*	jbenedict@milbank.com	+1-212-530-5696
James G. Cavoli	jcavoli@milbank.com	+1-212-530-5172
Christopher E. Chalsen	cchalsen@milbank.com	+1-212-530-5380
Scott Edelman *Firm Chairman*	sedelman@milbank.com	+1-212-530-5149
Christopher J. Gaspar	cgaspar@milbank.com	+1-212-530-5019
David R. Gelfand	dgelfand@milbank.com	+1-212-530-5520
Joseph S. Genova	jgenova@milbank.com	+1-212-530-5532
Douglas W. Henkin	dhenkin@milbank.com	+1-212-530-5393
Michael L. Hirschfeld	mhirschfeld@milbank.com	+1-212-530-5832
Robert C. Hora	rhora@milbank.com	+1-212-530-5170
Lawrence T. Kass	lkass@milbank.com	+1-212-530-5178
Atara Miller	amiller@milbank.com	+1-212-530-5421
Sean M. Murphy	smurphy@milbank.com	+1-212-530-5688
Daniel Perry	dperry@milbank.com	+1-212-530-5083
Stacey J. Rappaport	srappaport@milbank.com	+1-212-530-5347
Richard Sharp	rsharp@milbank.com	+1-212-530-5209
Alan Stone	astone@milbank.com	+1-212-530-5285

LITIGATION & ARBITRATION GROUP

Please feel free to discuss any aspects of this Client Alert with your regular Milbank contacts or any of the members of our Litigation & Arbitration Group.

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Milbank

Practice Group Leader

Errol B. Taylor	etaylor@milbank.com	+1-212-530-5545
Fredrick M. Zullow	fzullow@milbank.com	+1-212-530-5533

WASHINGTON, DC
International Square Building, 1850 K Street, NW, Suite 1100, Washington, D.C. 20006

David S. Cohen	dcohen2@milbank.com	+1-202-835-7517
Robert J. Koch	rkoch@milbank.com	+1-202-835-7520
Andrew M. Leblanc	aleblanc@milbank.com	+1-202-835-7574
Michael D. Nolan	mnolan@milbank.com	+1-202-835-7524

LOS ANGELES
601 South Figueroa Street, 30th Floor Los Angeles, CA 90017

Linda Dakin-Grimm	ldakin-grimm@milbank.com	+1-213-892-4404
Robert J. Liubicic	rliubicic@milbank.com	+1-213-892-4525
Jerry L. Marks	jmarks@milbank.com	+1-213-892-4550
Mark Scarsi	mscarsi@milbank.com	+1-213-892-4580