**Appeal number: FIN/2006/0015**

***PENALTY – Authorised person – Partnership – Breach of COB rules – Appropriate amount of penalty – Whether amount should be diminished by reason of financial circumstances of the relevant partners***

**UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)**
**FINANCIAL SERVICES**

**BETWEEN**

**FOX HAYES** **Applicant**

**- and -**

**THE FINANCIAL SERVICES AUTHORITY** **Respondents**

**TRIBUNAL: SIR STEPHEN OLIVER QC**
**COLIN SENIOR**
**CHRISTOPHER BURBIDGE**

**Sitting in public in London on 12 May 2011**

**Malcolm Jones in person**

**Richard Coleman, counsel, for the Authority**

## DECISION

1. This decision deals with the second and third questions remitted to the Tribunal by the Court of Appeal as a consequence of its judgment in *FSA v Fox Hayes* [2009] EWCA Civ 76. The Court of Appeal, having found that Fox Hayes had breached the FSA's Conduct of Business Rules in respect of certain financial promotions approved by Fox Hayes, at a time when it was a partnership, determined the appropriate penalty to be £954,770. The questions for us are:

(a) whether the penalty specified by the Court of Appeal should be diminished by reason of the financial circumstances of the relevant partners who would be liable to pay it; and
(b) what that penalty should be.

2. The background to this Decision is contained in paragraphs 2-11 of the Decision of the Tribunal released in April 2010. In summary the April 2010 Decision concluded that:

(a) notwithstanding the prior dissolution of the relevant Fox Hayes partnerships, the FSA lawfully imposed the penalty on them;
(b) liability is not confined to the assets of the partnership – the relevant partners are liable personally to meet the penalty out of their own resources;
(c) the liable partners in respect of the three financial promotions approved in February, March and May 2003 are Mr M Manning, Mr M Jones, Mr I Coupland, Mr S Coupland, Mr P Drazen, Mr R Jones, Mr Frazer and Mr Brill;
(d) the same partners, except Mr Brill, are the relevant partners in respect of the 17 financial promotions approved from August 2003 to June 2004; and
(e) (subject to the question of the liable partners' means) $3/20^{th}$ of the penalty of £954,770 suggested by the Court of Appeal should be apportioned to the breaches committed when Mr Brill was a partner and $17/20^{th}$ to the breaches committed after he had left the practice in July 2003.

**The circumstances of the enforcement proceedings and the position of the FSA**

3. These proceedings have been protracted. The investigation started in April 2004. Fox Hayes referred the FSA's Decision Notice to the Financial Services and Markets Tribunal in October 2006. An eight day hearing took place in June 2007 and a one day hearing in February 2008 following which the Tribunal issued its decision on the reference. The FSA appealed to the Court of Appeal which overturned the Tribunal's decision and remitted the questions of which the second two are the subject of this Decision. Further progress of the resolution of the outstanding questions has been delayed by Mr M Jones' appeal against the April 2010 Decision (which he subsequently withdrew). Mr Manning, Mr I Coupland, Mr Drazen and Mr Brill have

entered into IVAs. Mr S Coupland is bankrupt. Mr M Jones informed us that the prospects of any substantial recovery by creditors (to include the FSA) are slight. (We have no further evidence to go on.)

4. The FSA have informed us that they are conscious that, in view of the need to obtain financial disclosure in relation to all the partners, it will be likely to face considerable difficulties in recovering anything like £954,770 from them, even if the Tribunal were to direct it to impose a penalty of £954,770. The FSA has taken the view that the penalty should not be reduced below £454,770 (apportioned between the two partnerships), being the amount of Mr Manning's secret profits. The FSA considers that, in view of the benefits that could result from issuing a final notice without further lengthy delay, a penalty in that sum would satisfy the public interest.

5. In those circumstances we have been asked to decide whether consideration of the relevant partners' means could result in the penalty being set at less than £454,770. If the Tribunal were to accept the FSA's argument that it could not, then the FSA would invite the Tribunal to direct it to impose a penalty in that amount (subject to apportionment between the promotions). We should mention that Mr Drazen, Mr Manning, Mr S Coupland and Mr I Coupland informed the Tribunal that they would not be attending because the penalty would form part of their respective IVAs (in the cases of Mr Drazen, Mr I Coupland and Mr Manning) and bankruptcy (in the case of Mr S Coupland): Mr Brill has, we understand, informed the FSA that he is subject to an IVA and consequently would not attend the hearing. Mr Frazer and Mr R Jones have informed the Tribunal that they do not intend to contest the FSA's position. Only Mr M Jones has attended the hearing and made submissions as an Applicant.

**The statutory and other materials**

6. The penalties are, as the April 2010 Decision explains, to be imposed "on" the partnerships under section 206 FSMA in respect of the contraventions that took place during the existences of those partnerships. The FSA's statements of policy in relation to disciplinary measures, required by section 210 of FSMA, are in ENF and DEPP. For this purpose the two Fox Hayes partnerships are covered by the term "firm"; see section 32(4) FSMA which states that "Firm" means a partnership.

7. ENF 13.1.2G states the principal purposes of financial penalties as being –

> "… to promote high standards of regulatory conduct by deterring firms and approved persons who have breached regulatory requirements from committing further contraventions, helping to deter other firms and approved persons from committing contraventions, and demonstrating generally to firms and approved persons to benefits of compliant behaviour."

The factors to be taken into account in determining the amounts of a financial penalty, as set out in ENF 13.3.3G, include, where the person on whom the penalty is to be imposed is, as here, a firm –

(i) the seriousness of the conduct or contravention;

(ii) the extent to which the contravention or misconduct was deliberate or reckless;

(iii) "the size, financial resources and other circumstances of the firm … . The FSA may take into account whether there is verifiable evidence of serious financial hardship or financial difficulties if the firm were to pay the level of penalty associated with the particular contravention or misconduct … . The size and financial resources of a firm … may be relevant considerations";

(iv) "the amount of profits accrued or loss avoided".

8. DEPP 6.5 contains the principles for "Determining the appropriate level of financial penalty". First comes "Disgorgement" meaning that the firm "should not benefit from the breach". Second comes "Discipline" and third comes "Deterrence". By DEPP 6.5.3G the first step in the exercise is "the removal of any financial benefit derived directly from the breach."

9. Under the heading "Serious Financial Hardship" in DEPP 6.5D.1 is this passage:

"(1) The FSA's approach to determining penalties … is intended to ensure that financial penalties are proportionate to the breach. The FSA recognises that penalties may affect persons differently, and that the FSA should consider whether a reduction in the proposed penalty is appropriate if the penalty would otherwise cause the subject of enforcement action serious financial hardship.

(2) …

(3) The onus is on the individual or firm to satisfy the FSA that payment of the penalty will cause them serious financial hardship."

DEPP 6.5D.4G provides, as regards firms:

"(1) The FSA will consider reducing the amount of a penalty if a firm will suffer serious financial hardship as a result of having to pay the entire penalty. In deciding whether it is appropriate to reduce the penalty, the FSA will take into consideration the firm's financial circumstances, including whether the penalty would render the firm insolvent or threaten the firm's solvency. The FSA will also take into account its regulatory objectives, for example in situations where consumers will be harmed or

market confidence would suffer, the FSA may consider it appropriate to reduce a penalty in order to allow a firm to continue in business and/or pay redress.

(2) There may be cases where, even though the firm has satisfied the FSA that payment of the financial penalty would cause it serious financial hardship, the FSA considers the breach to be so serious that it is not appropriate to reduce the penalty. The FSA will consider all the circumstances of the case in determining whether this cause of action is appropriate, including whether … (d) the firm has spent money or dissipated assets in anticipation of FSA or other enforcement action with a view to frustrating or limiting the impact of action taken by the FSA or other authorities."

10. The main change found in DEPP, which we understand was published long after the misconduct, lies in the emphasis it places on "Disgorgement" which, in ENF, was the fourth of the relevant factors to be taken into account when determining the amount of a financial penalty. Otherwise the difference between the ENF and the DEPP provisions are of form rather than substance. We think it proper to follow DEPP 6.5. This contains the guidelines in force at the time when we are to issue our direction as to the appropriate action for the FSA to take; and the fact that the FSA are not now seeking to impose a financial penalty attributable to Discipline and Deterrence leaves Disengorgement as the sole consideration. However, the "serious financial hardship" positions in DEPP 6.5D.1G require consideration of whether a reduction in the proposed penalty is appropriate when otherwise "the subject of enforcement action" would suffer serious financial hardship.

11. With those provisions and guidelines in mind, we have one further observation to make. The FSA, as noted earlier, seek a penalty that matches the secret commissions taken by Mr Manning and which contains no punitive element. The FSA acknowledge that this is a concession. Without the concession we would be taking into account the seriousness of the contraventions and the extent to which they were deliberate or reckless. Those factors would in our view justify a penalty of at least £500,000; that view is supported by the Court of Appeal in paragraphs 48-50 of its Decision. Our view is based on the following among other circumstances. First, as a result of the breaches attributable to Fox Hayes' activities, investors lost a very large sum of money running into many millions of pounds. Second, the Court of Appeal found that Mr Jones' and Mr Manning's conduct was at least reckless and deliberate. Third, the misconduct was committed repeatedly over a long period of time. We note also that Lawrence Collins LJ (with whom Wilson LJ agreed) summarised Fox Hayes' role in the investors' losses as follows:

> "It is impossible to resist the conclusion that the promoters were using a small firm without any relevant expertise, and with the senior partner who was (to put it at its lowest) less than scrupulous and who had a substantial personal stake in the success of their efforts, because a substantial firm with real expertise would not have touched this

> business. They were using a firm not only to purport to comply with the FSA rules, but to add an air of respectability to their documents. Fox Hayes knew that the whole purpose of the offer of free research reports was to act as a prelude to solicitation of purchases of the OTC Bulletin Board shares. Mr Jones should have been alert to the fact that the use of the firm's name facilitated the approaches to potential investors."

12. Mr M Jones' case is that Mr Manning obtained and kept the entire secret commission. That was the totality of the benefit from the breach. The other partners knew nothing about Mr Manning's secret profit at least until January 2006 (see paragraph 30 of the Decision of the Court of Appeal). Consequently neither partnership had asserted any claim against Mr Manning and no part of the assets of those partnerships represented, directly or indirectly, the secret profits taken by Mr Manning. Mr M Jones said he understood Mr Manning's debts (arising from property transactions) were several million pounds more than his assets. He also understood that Mr Drazen and Mr J Coupland, both in IVAs, were unlikely to provide more than two or three pence in the pound for their creditors. Thus Mr M Jones and the other two solvent partners were, as partners, likely to have to bear most of the penalty with little chance of recoupment from the others. That would have resulted from circumstances in which Mr Jones had not been enriched at all; there was nothing that he could be required to disgorge.

13. We should mention that Mr M Jones' representations relate to his own position.

14. We recognise that Mr M Jones has no money and no assets that are attributable to his having been unjustly enriched. He was however a partner in both the partnerships. The secret commissions are, the Court of Appeal has ruled, to be regarded as assets of those partnerships: see paragraph 52 of their Decision. It is those assets which are to be disgorged and which are the prime ingredients in the penalty. The penalty has been imposed "on" the partnerships and as partner Mr M Jones is liable for the penalty. That is the tough but inevitable implication of his having been one of the partners

15. What then should be the right amount of the penalty? It should not in our view be less than the secret profits obtained by Mr Manning which are, as just mentioned, to be regarded as assets of the partnership. Those were received because Mr Manning had arranged for Fox Hayes to approve and to undertake the work done in connection with the financial promotions. In doing so Fox Hayes, through its partners, acted deliberately and recklessly over a long period of time and investors spent over 20 million US dollars on shares that lost most of their value. To impose a penalty that contains no punitive element is, in the particular circumstances of these enforcement proceedings, understandable. To impose a penalty that failed to reflect what the partnerships obtained would be wrong. The breach was so severe that it would be inappropriate to reduce the penalty to below the figure of £454,770.

16. For the reasons we have given, we direct the FSA, in accordance with section 133(5) FSMA, to impose on Fox Hayes penalties of £68,215.50 in respect of the three financial promotions approved in February to May 2003 and of £386,554.50 in respect of the seventeen financial promotions approved from August 2003 to June 2004.

**SIR STEPHEN OLIVER QC**
**JUDGE OF THE UPPER TRIBUNAL**
**RELEASE DATE: 3 June 2011**