Compson v FSC & Weal v FSC - further musings

by Nigel Feetham, Partner

As a lawyer, academic writer, former member of the FSC and director (a position I have held on the boards of leading corporates), I believe Compson v FSC & Weal v FSC is an important decision. My Briefing Note published on Friday 30 April has already received a lot of interest. In this article I will turn to some of the questions I have been asked by readers.

On the facts I think this decision is not surprising and there is useful commentary from Mr Justice Jack as to how directors should discharge their directors duties. I do believe, however, that Compson v FSC & Weal v FSC is very fact-specific and confined to cases where there are 'peripheral' allegations of impropriety (by that I mean on someone else's part). That too is my academic experience, namely that directors are more likely to be found in these unfortunate circumstances to have been in breach of their duties. It is one of the occupational hazards of discharging a position of responsibility, so to speak.

My reading of this case also is that had there been no alleged impropriety (by someone else) and no patent 'red flags' (warning signs), the FSC would not have pursued Mrs Compson's disqualification. That could create problems for the industry as a whole by potentially stifling growth and hurting the economy. In this respect I think the current and former CEO have got that regulatory balance right - disqualification (rather than the lessor sanction seen in respect of Mr Weal) must be a measure of last resort, unless of course someone has made persistent mistakes and not learnt from them.

On the interesting question of how much deference a Court should pay to decisions of regulators, the problem is that if too much deference is given then no decision would ever be overturned on appeal and the appeals process would offer little or no comfort to appellants. Clearly regulators can make mistakes. The global financial crisis of 2008 also paved the way for new regulations and enforcement powers in the US and elsewhere, but with this comes the greater necessity of being able to challenge regulatory decisions.

There is no denying that the Compson case is not good news for EIF directors that fail to meet the governance expectations set out in the Judgment. I was part of the government working group that recommended and drafted the original EIF regulations and at the time we all wanted a funds regime for experienced investors that was subject to 'light touch regulation'. What the Compson case shows is that there is no such thing as 'light touch regulation' when things go wrong and where investors could stand to lose money. Indeed, commensurate with 'light touch regulation' directors end up with a higher standard of responsibility, and I had never assumed otherwise.

Finally, it will be recalled that firms of UK chartered surveyors had given "unrealistic" valuations, that, according to the Judge, contained "special assumptions... [which] are effectively fantasy valuations", and which the directors (even if they were not themselves property experts) should not (and objectively could not) have relied on. The Judge therefore directed that the matter be reported to the professional body of the Royal Institution of Chartered Surveyors for investigation. In my view this also impacts tangentially on insurance companies where an insurer values reserves at below the actuaries best estimate, or use actuaries that cannot objectively support their own optimistic view on claims reserves. They would now face difficulty in the light of this ruling, although equally the

Hassans, 57/63 Line Wall Road, Gibraltar.
Tel: +350 20079000 | Fax: +350 20071966 | info@hassans.gi | www.gibraltarlaw.com

ruling places more responsibility on the FSC where the directors are indeed reserving claims at below the actuaries best estimate.

An interesting question arises here for lawyers too in relation to the rendering of 'legal opinions' in support of transactions if a Court held that these were not sufficiently cogent and/or reasonably held opinions, and/or are subject to such 'special qualifications' as to render the opinion liable to be misused and mislead third parties placing reliance on them. Likewise for a certification by an auditor or accountant. Whilst this cannot be ignored, it should not be overstated either.

Of course, we will not know what the full implications of this decision will be until another appellant or plaintiff brings a case to Court. I also remind myself that it was a few months ago that the Court of Appeal in the Cayman Islands overturned the first instance decision (2011) against the directors in Weavering. Whilst a litigant is always wise to consider settling disputes and avoid the uncertainty of litigation, equally, everything is always up for grabs for a party with sufficient resources to test the position in the Court and on appeal.

Nigel Feetham is a partner at Hassans (a Gibraltar law firm) and Visiting Professor at Nottingham Law School, Nottingham Trent University. Nigel is also the author and co-author of a number of books.

Hassans, 57/63 Line Wall Road, Gibraltar.
Tel: +350 20079000 | Fax: +350 20071966 | info@hassans.gi | www.gibraltarlaw.com