**Briefing note** **30 April 2015**

## Nigel Feetham analyses the occupational hazard of the company director following a recent judgement

On 29 April 2015 the Supreme Court of Gibraltar handed down a Judgement which directors/controllers should take serious notice of. The case is Compson v FSC & Weal v FSC. It concerns an unsuccessful appeal against the decisions of the FSC to declare an investment fund (EIF) director not fit and proper and impose a lessor sanction on another (reflecting his more limited involvement). It is the first such appeal to the Supreme Court and is now a precedent for future cases.

Not only did the Judge find in favour of the FSC and dismissed the appeal against the sanctions imposed against the appellants, but he also made a number of observations in his Judgment, which, if followed in future cases, would make it very difficult to challenge decisions of the regulator on questions of fitness and propriety. These include:

At paragraph 59: "The FSC and its chief executive are likely to be better placed than the Court to determine what measures are necessary in order to protect the good reputation of Gibraltar, to protect consumers and to reduce crime, as well as the other regulatory objectives...The Court in my judgment should be reluctant to interfere with a sanction imposed by the chief executive, unless clearly wrong or if the chief executive has taken irrelevant considerations into account."

At paragraph 106: "I accept that the sanction imposed by the chief executive is severe... However, the sanction imposed is in my judgment fully justified... Unless such a sanction were imposed, it is likely that the good reputation of Gibraltar as a financial centre would be damaged. Moreover the chief executive was fully entitled to decide that the sanction was necessary to protect consumers and to reduce financial crime.

Hassans, 57/63 Line Wall Road, PO Box 199, Gibraltar
Tel: +350 20079000 Fax +350 20071966 catherine.knock@hassans.gi www.gibraltarlaw.com

Deterrence of other directors from failing to monitor the activities of companies on whose board they sit is a justifiable regulatory consideration".

At paragraph 109: "The chief executive is better placed than I am to determine what sanctions are appropriate to further the regulatory objectives of the FSC as set out in section 7(2) of the FSA 2007."

It is important to emphasise that there was no finding of dishonesty either by the Court or the FSC. The sanctions by the FSC were imposed for breach of directors duties (namely, failing to act with due skill, care and diligence) and the Judge found that the breaches clearly supported the FSC decision, thereby dismissing the appeal.

In short, whilst accepting that the director's involvement "has been a personal and professional disaster" for her, the Judge held that the director had failed to "ensure that valuations satisfying the requirements of the PPM were obtained" and had also "approved the unusual and disadvantageous terms of the contract for the purchase of [property]".

**What comes out of this Court Judgment**?

This Court decision does have implications for how directors/controllers/managers discharge their directors' duties.

The first point, in my view, is that a Court following this precedent is unlikely to overturn a decision of the FSC as to the fitness of a director/controller/manager unless that decision is patently wrong.

Second, the Judge was very critical that the director had not properly considered transaction documentation: "I should add that even on the assumption (which I refuse to draw) that she did not know these facts, her failure to read the documentation would in my judgment have been grossly negligent and a breach of her duties as a director". Further, the Judge held: "She had a personal responsibility as a director to know the terms of the PPM and she knew Advalorem was breaching its terms. She knew the terms of the purchase of Whistle were unusual and must have known that

they were disadvantageous to investors in Advalorem. These, and only these, matters are those on which the chief executive held that she failed to act with due skill, care and diligence and I agree with that finding." This was an important conclusion in the Judge's decision and puts directors on notice that a Court would expect them to properly consider and challenge agreements before approving them.

Third, the argument that the director could rely on the expertise of other directors, as a defence, was rejected by the Judge.

Fourthly, the director had failed to obtain competent professional advice - in this case, an erroneous property valuation report was not appropriate. Again, directors are put on judicial notice that they are expected to take proper professional advice. It is also of note that the Judge has asked for the matter to be reported to the relevant valuer's professional body the Royal Institution of Chartered Surveyors for investigation (paragraph 16, 78 et seq and particularly 84).

Finally, the fact that investors (pension funds) might stand to lose many millions (which is as yet unclear) in my view underpinned the Court's finding that she had failed to act with due care, skill and diligence.

What swung the pendulum in this case, in my opinion, is that the transactions were found not to be bona fide between parties at arms length but were tainted with allegations of impropriety (notwithstanding that there was no finding of dishonesty or indeed knowledge of the seeming impropriety against the appellants). The decision is a "wake up call" for any director/controller/manager involved in the financial services sector that ignores the salient points arising from this Judgment.

Whilst the case is obviously very fact-specific, it is unlikely that the legal principles set out in the Judgment will be reversed by the Courts in the near future. The debate for directors/controllers/managers is whether this Court decision is a game-changer in a number of important respects, principally the fact that the regulator's enforcement hand is strengthened given the deference paid to the FSC by the Court and that disputes with the regulator and/or allegations of breach of directors duties by third parties (e.g. investors, shareholders, liquidators) are more likely to be settled out of Court, in the light of this Judgment, than risk taking the matter to Court.

It would be a shame, however, if skilled individuals are put off by the occupational hazard of serving as directors. Equally, it is important that regulators continue to exercise their enforcement powers proportionately to avoid depriving the industry of valuable talent. **It is recommended that all Gibraltar regulated companies and companies that raise monies from external investors (e.g. pension funds) review their internal processes/governance in the light of this Court decision.** My own reading of this case is that the FSC relies heavily on the two Gibraltar based EIF Directors under a regulatory regime often described as 'light touch' (for experience investor funds) and therefore are more likely to hold these directors accountable when things go wrong.

**For further information, please contact Nigel Feetham at nigel.feetham@hassans.gi**

*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.*

**ENDS**

**About Hassans**

Hassans was founded in 1939 and is the largest law firm in Gibraltar with 36 partners, over 55 other lawyers and 250 staff in total.

Hassans was the first firm in Gibraltar to structure itself as a modern international law firm, with separate departments for different fields of specialisation and the first outside of the UK to accredited by the Law Society of England and Wales to offer training contracts to aspiring solicitors, this puts them firmly at the forefront of legal training in Gibraltar.

The firm has an international clientele, links with major European and US law firms and has consistently been listed as the leading law firm in Gibraltar by Chambers and Partners and Legal 500 across the majority of its practice areas. http://www.gibraltarlaw.com/