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10 April 2008

Anna Colban
Secretary to the AADB
Financial Reporting Council
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16 APR 2008

Dear Ms Colban

I enclose a response to the FRC's accountancy scheme review consultation paper dated January 2008.

We have responded to 2 of the 7 questions raised in the consultation paper, namely those concerning the definition of "relevant conduct" and those concerning the proposed restrictions of the Tribunal's discretion to award costs against the Board.

If you have any questions concerning this response, I should be happy to discuss these.

Yours sincerely

Ian Hammond
Partner

Responses to the FRC's Accountancy Scheme Review consultation paper dated January 2008

Definition of "Misconduct"

Question 1

a) Do you agree in principle with the proposal to require a tribunal to find that any allegations proven amount to 'Relevant Conduct' before making an adverse finding?

b) Do you agree with the proposed definition of 'Relevant Conduct'?

The proposed 'relevant conduct' definition confuses the *nature* of the underlying conduct and its possible *consequences*.

In terms of the consequences of the relevant conduct, the threshold for cases that are suitable for investigation by the Board is already well-established, and there is no suggestion that it should change: the Board can only begin an investigation if the matter raises or appears to raise *"important issues affecting the public interest in the UK and Ireland".*

The Board's own guidelines as to whether or not a matter raises or appears to raise important issues affecting the public interest set out the (non-exhaustive) factors the Board will take into account in making a decision to investigate. These include:

(A) whether there appears to be serious public concern or damage to public confidence in the accountancy profession in the UK; and

(B) all the circumstances of the case, including its nature, extent, scale and gravity (these to be considered by reference to such matters as number of people adversely affected, the sums of money involved and whether the matter concerns a body in which there is a public interest).

Unless a matter satisfies these guidelines, it will not be appropriate for the Board to investigate it.

There is therefore no need for the definition of "relevant conduct" to address the possible consequences of the conduct, as this would merely duplicate – but in slightly different terms – the existing guidelines. Sub-paragraph (i) and arguably sub-paragraph (ii) of the proposed definition are therefore redundant.

As to the *nature* of the relevant conduct, the problem with the proposed sub-paragraphs (iii), (iv) and (v) is that they contain no materiality threshold. As these sub-paragraphs stand, *any* infringement, no matter how minor or trivial, of any regulation or guidance will constitute an *"act of misconduct"* for these purposes. Indeed, it is arguable that the AADB's jurisdiction would extend to a wider range of minor infringements than would the ICAEW's under its own disciplinary scheme.

It is clear from the guidelines for referral of cases to the Board which are set out in Annex B to the Consultation Paper that this cannot have been what was intended. In determining whether or not a matter raises issues affecting the public interest, the Board must have regard not only to the consequences of the conduct, but also to its seriousness: specifically, its *"extent, scale and gravity".* It is apparent that only misconduct alleged to have been on a significant scale was intended to fall within the Board's jurisdiction.

Sub-paragraphs (iii) to (v) should therefore be made subject to a materiality threshold by adding after the current wording something along these lines: *"....in such a way, or to such an extent, as to bring discredit on the accountancy profession."*

Proposals Concerning Payment of Costs

Question 7

a) Do you agree that a balance must be maintained between fairness to a successful respondent and ensuring that the regulator is not constrained from bringing proceedings because of the possibility that costs may be awarded against it?

b) Do you agree that the proposal in respect of costs assists in maintaining that balance?

Response

We agree that a balance must be maintained between fairness to a respondent and ensuring that the regulator is not constrained from bringing proceedings because of the possibility that costs may be awarded against it.

However, we consider that the proposal to limit the tribunal's discretion to award costs in favour of a respondent against the Board to circumstances where there has been 'misfeasance' by the Board, tips the scales too far in favour of the Board. It is hard to imagine *any* situation in which the Board would exercise power *'intending to cause harm'*, or *'acting in the knowledge of the illegality of an act whilst knowing the probability of causing harm'*, which means, in reality, that the Board is extremely unlikely to get costs awarded against it. That would fail to achieve the Board's aim of providing a *"demonstrably fair"* system.

The consultation paper expressly states that neither the Board nor the FRC has reserves available to meet costs awards of the kind made in the *Mayflower* case, and it is clear that this consideration has had a substantial impact on the proposals advanced. However, to begin by considering the Board's funding position is to put the cart before the horse. The AADB has committed to a system that is "demonstrably fair" and any analysis of the position must therefore begin with consideration of what is a fair balance between the Board and the professional who is the subject of the disciplinary proceeding.

We agree that the usual *'costs follow the event'* rule should not apply in relation to cases brought by a public interest regulator, but consider that the *'misfeasance'* test plainly sets the bar too high.

The Board says it has been guided by the Court of Appeal decision in *Baxendale-Walker v Law Society* [2007] EWCA Civ 233, which held that the usual rule that *'costs follow the event'* does not apply to a public interest regulator. However, we point out that the Board, in adopting the 'misfeasance' test, does not in fact follow the test as laid down in *Baxendale-Walker*. The test that *Baxendale-Walker* endorsed was that an order for costs should not ordinarily be made against the regulator, unless the complaint is *'improperly brought'* or the proceedings are *'a shambles from start to finish'*. The Court of Appeal also appeared to approve the reasoning of the judge below, who said that *'absent dishonesty or lack of good faith'*, a costs order should not be made against a regulator unless there is a good reason to do so (emphasis added).

The proposed 'misfeasance' test adopts parts of the rationale for the decision in *Baxendale Walker* but omits the important caveats concerning proceedings which are *"a shambles from start to finish"* or where there is other "good reason" for a costs order to be made. By so doing, the proposed test goes further than the Court of Appeal went in *Baxendale-Walker* and, as noted above, would have the consequence that the Board is never exposed to the risk of any cost liability. That cannot reasonably be called a "balance".

We note that the proposed *'misfeasance'* test also goes significantly further than the test as set out in *Law Society v Adcock* [2006] EWHC 3212. In *Adcock,* the court felt that the first instance judgment in *Baxendale-Walker* put the matter too highly in favour of the regulator. The Court of Appeal in *Baxendale-Walker* did not expressly disapprove of the reasoning in *Adcock,* but it did acknowledge the decision, said it would *'address and resolve'* the difference of approach, and upheld the trial judge's order and it seems, his reasoning.

Further, there should in our view be costs implications in cases where the regulator maintains proceedings when it is no longer justified in doing so. As discussed in the *Mayflower* costs decision, regulators have a duty to review a complaint once it has been brought, against the available evidence, and to consider whether or not it is reasonable to maintain the complaint at hearing. In that case, it was found that the regulators should have withdrawn the complaint after PwC had served its substantial evidence. Doing so would have avoided the costs of the hearing and much of the costs of the preparation for the hearing. The tribunal took this as a factor in its decision as to costs. The proposed *'misfeasance'* test would not catch this circumstance.

The Board notes in its consultation paper that the Financial Services and Markets Tribunal (which determines decisions of the FSA which are referred to it) may order that a party must pay another's costs only where it considers that party to have acted *"vexatiously, frivolously or unreasonably"* or where it considers that the FSA decision referred to it was 'unreasonable'.

We consider that a threshold of this sort would strike the balance between the parties that the Board seeks, such that proceedings reasonably brought, or pursued, will never result in an adverse costs order, but proceedings brought or maintained vexatiously, frivolously or unreasonably, or which are, in *Baxendale -Walker* terms, a *"shambles from start to finish"* will carry the risk of doing so.

Simmons & Simmons

10 April 2008