NEW SQUARE

Litigation and Regulatory Contrasts for Accountants following Mehjoo

Graeme McPherson QC

Wednesday July 9 2014

MEHJOO – What the Court of Appeal Decided and what it did not

Mehjoo – First Instance Press

"Accountants must help tax avoiders, rules judge" **– The Times**

"Millionaire Iranian businessman who was granted asylum in UK at age of 12 WON'T have to pay £850,000 tax bill, High Court rules" – **Daily Mail**

"MEHJOO: If you don't want to get sued,
know what you don't know!" – **Gander Tax Services**

Mehoo – The Facts

- Iranian Domicile?
- Long Standing Relationship
- Retainer Letter
- Bearer Warrant Planning
- Causation
- The Claim

Silber J's Decision

- 205 pages
- Wide Definition of "Tax planning" – [123]
- Retainer – "Course of dealing" – [128]
- The Meeting of 2nd October 2004 – [168]
- The List of Points – [161]
- 3 point breach – Domicile, Advantages and Referral – [175]
- Bearer Warrant Planning and Certainty – "No material risk of a Successful Challenge" – 376
- Damages – Tax plus fees of alternative scheme

What the CA Decided

- 20 pages
- Difference between “routine tax advice” and “sophisticated tax planning” – [40]
- No extension to retainer letter – [44]
- D did advise of possible other schemes – [47]
- No reason to suppose domicile of advantage – [56]

What the CA did not Decide

- Was the Claimant's Expert Evidence Admissible – Sansom v Metcalfe Hambleton?
- Was Mr Mehjoo domiciled in UK?
- Did the hypothetical BWS scheme "work" – Grimm v Newman?
- Is there a "Non-Dom" Specialism?
- What C would have done given proper Advice
- What was the proper Quantum of Any Loss?

Conclusion

- At trial C cleared every hurdle
- On appeal he failed to establish either duty or breach
- The CA did not have to decide causation, admissibility or quantum issues – which were the most interesting

Other potential developments

- Scope of duty
- Trading Losses
- Illegality & *Ex Turpi Causa*
- Counterclaims

Potential application of *SAAMCO*:

- an auditor has no duty to protect a company from decisions taken by management in full knowledge of the true position;
- recoverable losses are limited to the amount of any misstatement in the audited financial statements;
- the loss against which an auditor has a duty to protect the company is limited to the shareholder equity in the company.

Trading Losses

- Context: corporate collapse

- Present position in summary: they will not be recoverable in every case. But when will they and when will they not?

The Present Position

Galoo:
"The breach of duty by the defendants gave the opportunity to Galoo and Gamine to incur and to continue to incur trading losses; it did not cause those trading losses, in the sense in which the word "cause" is used in law"

versus

Temseel:

"It seems to me that the complaint which is made in the present case, whether or not it is well founded, is of a different nature. The complaint made by the company is not simply that it was allowed to continue trading, but rather that in reliance upon the figures which had been supplied to it and represented to be correct it continued to trade in a particular manner.."

Ex turpi

- Attribution following *Stone & Rolls*.

"The balance of authority suggests that the Hampshire Land principle is not triggered where the company is used as an instrument of a fraud targeted against a third party victim, resulting in loss to the company only as secondary victim, in circumstances where the attribution is invoked by those not party to the relevant fraud."

See Popplewell J. in *Madoff*.

So Hampshire Land will not apply where:

- The directors fraud (like the Madoff Ponzi scheme) was directed against third party victims of that fraud rather than the company itself.
- The company was only a secondary victim of the fraud.
- The auditors are not party to the fraud.

The "Barings Counterclaim"

- Structure and form:
  - audit undertaken on the basis of letter of representation;
  - representations in letter of representation false;
  - auditors rely on representations in completing audit and would not have completed audit but for representations;
  - accordingly, any liability arising on the audit was caused by the reliance on the false representations for which company vicariously liable.
  - circuity of action.

- The position in principle: *Barings*

- The position in practice: esp. as regards proving reliance.

- The "very thing" argument.

MEHJOO

DISCIPLINARY v COMPENSATORY COMPARE & CONTRAST

Constituent Elements of Proceedings

- **Compensatory**: a Claimant, duty, breach, causation / contributory negligence, and loss

- **Disciplinary**: no Claimant, must prove Misconduct, causation / contributory negligence and loss not necessary for Misconduct though likely to be relevant to Sanction

Consequences of Absence of a Claimant

- Para 1(2) of the Accountancy Scheme
"To protect the public, maintain public confidence in the accountancy profession and uphold proper standards of conduct ..."

- Consequences of the different starting point for regulatory investigations & disciplinary proceedings

- Attitude of Tribunal as opposed to that of Court

The Definition of Misconduct

"an act or omission or series of acts or omissions ... in the course of his professional activities ... or otherwise, which falls significantly short of the standards reasonably to be expected of a Member ... or has brought, or is likely to be bring, discredit to the Member or to the accountancy profession"

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- Not just how, but what the Member should do

- Court: the ambit of duty prescribed by retainer

- FRC/Tribunal: assessment of Member's conduct by reference to protection of public, public confidence & proper standards of conduct

- Implications of a protection based approach

The standard reasonably to be expected – how?

- *FRC v Deloitte & Touche and Einollahi*, Sept 2013
- no requirement of moral blameworthiness rather "real seriousness"

"*24. ... the conduct has to amount to more than mere carelessness or negligence and has to cross the threshold of real seriousness*"

- mere negligence not constitute misconduct but

"*25. A single negligent act or omission is less likely to cross the threshold of "misconduct" than multiple acts or omissions ... A single negligent act or omission, if particularly grave, could be characterised as "misconduct" ...*"

- conceptually, when is it not serious to be negligent?

Conduct likely to bring discredit

- moral blameworthiness or opprobrium required

- large area of discretion for Tribunal

- a redundant limb of the test for Misconduct?

- tendency towards multiple allegations of falling short of standards reasonably to be expected

The absence of other Defences

-It is for Executive Counsel to determine if there is public interest in the prosecution

-Causation, loss and damage not required though important for Sanction

-No investigation of Claimant's behaviour

-The removal of balancing effect of evidence & cross-examination of Claimant

The Accountancy Scheme & Sanctions

- Impact on the Member & Firm: exclusions, fines & reputational damage – no confidential settlements
- Deloitte: a severe reprimand and a fine of £14m
- Mr Einollahi: fine of £250k and 3 year exclusion
- the February 2013 Sanctions Guidance

"32. ... A tribunal will normally take into consideration ... in the case of a Member Firm, its size/financial resources and the effect of a Fine on its business ...
33. In the majority of cases involving the imposition of a Fine ... the amount of revenue generated by the Firm or the business unit(s) involved in the Misconduct will be a relevant factor to take into account, when assessing the size of Fine which would be necessary ... to act as a credible deterrent"

Sanctions – part of a changing world

- Fines by reference to revenue

- FCA fines & Closure Notices

- SRA fines: *Fuglers v SRA [2014] EWHC 179*
- use of client account as banking facilities
- Popplewell J: *"In those circumstances, a total fine of £75,000, being six months profits for a notional firm making a 15% profit on an annual turnover of £1 million, is not a disproportionately large sum."*

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