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The FCA Final Notice on Redcentric PLC – Does it Signal the Enforcement Zeitgeist of the COVID-19 Period?

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At the end of June 2020, the Financial Conduct Authority (the "FCA") issued a public censure to Redcentric PLC for market abuse resulting from significant accounting errors. The resolution is particularly eye-catching because the FCA elected not to fine Redcentric, but instead settled the matter with a lenient resolution acknowledging the vital work conducted by the company in supplying IT solutions to the NHS during the COVID-19 period and also the creation of a shareholder compensation scheme. The FCA also announced criminal charges against the implicated individuals. This resolution comes in light of the Financial Reporting Council's (the "FRC") sanction in June 2019 against Redcentric's audit firm and partners.

We believe Redcentric's resolution with the FCA may come to typify a more creative and pro-business style of enforcement of market abuse allegations conducted in parallel with a criminal investigation and an FRC investigation.

This note sets out the factual background to the case and some observations about the future direction of FCA enforcement in the context of the economic conditions created by COVID-19.

Redcentric

Redcentric is an AIM-listed IT services provider. It provides network, cloud, and collaboration services to private and public sector organisations, including the NHS. Redcentric grew rapidly through acquisitions between 2013 and 2016, acquiring three companies.

On 7 November 2016, Redcentric announced that its audit committee had undertaken an internal review of Redcentric's interim results for the 6 months ending September 2016. It had discovered misstated accounting balances in Redcentric's balance sheet. The Redcentric Board commenced a forensic review of its current and historic balance sheets. It was reported at the time that the Chief Financial Officer had resigned with immediate effect and approximately 62% was wiped off the firm's share price.

Following its own investigation, with which Redcentric fully co-operated, the FCA found that Redcentric knew or could reasonably have been expected to know that the information in respect of cash and net debt, published on 9 November 2015 and 16 June 2016, was false or misleading.

Redcentric accepted that as a result of the false or misleading information the market price for Redcentric shares was artificially inflated. Purchasers of shares between 13 November 2015 and 7 November 2016 paid a higher price than they would have paid had the false impression not been created. The FCA estimated the losses to affected shareholders to be approximately £43 million.

In a first for an AIM-listed company, Redcentric offered to implement its own scheme to pay compensation of approximately 25p in the £ to those affected by the harm it caused as a result of market abuse. As a result, the FCA decided not to issue a financial penalty, rather that public censure would be

sufficient penalty. In reaching this decision, the FCA took into account "*the potential adverse consequences for Redcentric's business, and therefore its investors and customers, if in addition to compensation, a substantial penalty had been imposed*". The FCA was concerned that the "*vital public services*" carried out by some of Redcentric's customers could have been disrupted had Redcentric's financial viability been affected by a fine.

Separately, the FCA acknowledged the assistance and co-operation provided to its investigation by the FRC. The FRC announced on 13 June 2019 that it had fined PwC, Redcentric's auditor, £4,550,000. The two audit partners were also fined and severely reprimanded for their "*failure to exercise professional scepticism*".

Finally, the FCA announced that it had charged three former employees of Redcentric with a variety of criminal offences including making false and misleading statements to market, providing false and misleading statements to auditors and false accounting.

The Wider Landscape

Since Redcentric first brought its concerns to the attention of the FCA and the FRC, there have been a growing number of corporate collapses linked to the apparent failure of audit, beginning with Carillion PLC in 2018 through to matters such as Patisserie Holdings PLC and NMC Healthcare PLC, and most recently to Wirecard. As part of its attempt to restore trust in the auditing of UK PLCs, on 7 July 2020, the FRC issued landmark principles for the operational separation of the Big Four accountants. This step is generally recognised to be only the beginning of significant reforms to UK audit rules.

For its part, the FCA has also used the unprecedented conditions created by COVID-19 to signal to firms and market participants that they should be vigilant to the increased risks of market abuse. Since late May, it has published a number of notes to convey its expectations. In its *Market Watch* (published on 27 May 2020), the FCA highlighted the increased risks of market abuse created by emergency capital raising and working from home arrangements, and its expectations around the measures and enhanced controls it expects listed companies and firms to implement to mitigate these risks. This guidance was supplemented in June 2020 by a note on identifying, controlling and disclosing inside information.

Conclusions

Redcentric successfully argued that had the FCA imposed a financial penalty on it, there was a risk that critical services in the fight against COVID-19 could have been disrupted. While the FCA noted the circumstances of this settlement were "unique", it will be interesting to see whether other public interest arguments mitigating penalty will be agreed with other firms and, if so, how widely this pro-business continuity approach will be applied.

Given the FCA's heightened publicity of the risks of market abuse created by the necessary emergency arrangements to respond to the pandemic, FCA supervisory teams will expect firms, in applying the General Notification Requirements (SUP 15.3), to be particularly mindful to bring relevant issues regarding lapses in market abuse controls to their attention.

With the FCA and the FRC considering a number of corporate failures involving alleged false statements made by senior managers and insufficient scepticism exercised by auditors, the Redcentric matter could mark the start of a trend towards enforcement resolution involving parallel civil, criminal, and regulatory proceedings that collectively facilitate business survival, realistic shareholder compensation, and sanction of the culpable individuals. Such resolutions will require very careful and nuanced legal representation by lawyers highly familiar with shareholder damages claims, the FRC, FCA and Crown Prosecution Service or the Serious Fraud Office.

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