INTRODUCTION TO UK SECURITIES LAW

BY

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INTRODUCTION

THE KEY PRINCIPLES OF SECURITIES LAW

This section is a summary of the key principles of securities law.[1] It is meant to be an introduction to the topic to orientate you before getting into the more detailed material in the rest of this document. Self-evidently it cannot go into detail in the space available. Instead, its purpose is to state some of the fundamental points and to provide a cross-reference with the beginning of the discussion of the relevant principles in the main text.

The purpose of this discussion of the "Key Principles" is simply to summarise the principles governing securities law in the UK. Securities law can be a very complex subject – and is strictly outside the ambit of company law, but if one wants to study corporate finance, then one cannot avoid this detail. So, the Key Principles discussed here are merely a summary of the more detailed discussion to follow. The more detailed discussion includes abstracts of the relevant legislation. You are not required to know any more of the regulation than is made available in these materials, although wider reading will of course inform your study and writing in this field.

The sources of securities law

The regulation of securities markets is derived from the relevant EC securities directives[2] as supplemented by the Commission's "technical regulations": this structure is part of the "Lamfalussy process" for creating financial services law. These directives were then implemented into UK securities law by Part 6 of FSMA 2000[3] (as amended by subsequent legislation[4]) and by secondary legislation introduced under FSMA 2000;[5] and by means of FSA securities regulation in the form of the Listing Rules, the Prospectus Rules, and the Disclosure and Transparency Rules.

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[1] This Introduction is based heavily on the "Introduction" to Alastair Hudson, *Securities Law* (Sweet & Maxwell, 2008).

[2] These directives are considered in detail in Alastair Hudson, *Securities Law*, "EC securities regulation", para 2-83 *et seq*. There are five Directives which are of significance at the time of writing. First, the Consolidated Admission and Reporting Directive of 2001 (Council Dir. No. 2001/34/EC); which consolidates, as its name suggests, the principles in the earlier slew of Directives. Secondly, the Prospectus Directive (Directive 2003/71/EC (2003 OJ L 345)) which was implemented by means of the new listing rule arrangements effected by the FSA as of 1st July 2005. Thirdly, the Transparency Obligations Directive (Directive 2004/109/EC (2004 OJ L 390)) which was scheduled implemented in the UK by the Companies Act 2006. Fourthly, the Market Abuse Directive, dealing with the disclosure of price sensitive information and insider dealing, implemented in 2005. Fifthly, the International Accounting Standards Directive, implemented in 2005 relating to the form of accounting information provided by companies.

[3] Repealing the Financial Services Act 1986.

[4] In particular as amended by the Prospectus Regulations 2005 (SI 2005/1433), and by various provisions of the Companies Act 2006.

[5] In particular the Prospectus Regulations 2005 (SI 2005/1433), repealing earlier statutory instruments, and The Financial Services and Markets Act 2000 (Market Abuse) Regulations 2005 (SI 2005/381).

Financial services regulation more generally is also governed in the UK by FSA regulation of the conduct of business, including the manner in which different categories of client are to be classified and treated (derived from the Markets in Financial Instruments Directive ("MiFID")); advertisement of financial instruments by way of "financial promotion"; the control of "market abuse" (derived from the Market Abuse Directive ("MAD")) and insider dealing (from various directives through Part 5 of the Criminal Justice Act 1993; and the statement of the core principles governing the proper behaviour of businesses.

Securities law as a whole is then rounded out with the general law dealing with issues as diverse as misrepresentations in offering documents, the fiduciary duties of some participants in securities transactions, remedies for loss at common law, rights to recover property or to recover loss in equity, conflict of laws, and the many criminal offences relating to securities transactions including insider dealing, market manipulation, theft, fraud and so forth. There are also powers for the FSA to impose "civil penalties" in relation to market abuse, and heads of civil liability to pay compensation under (particularly) ss.90, 90A and 150 of FSMA 2000.

Offers of transferable securities to the public

The obligation to publish a prospectus arises when there is an offer of transferable securities to the public, or where an application is made to have securities admitted to trading on a regulated market, or otherwise where the issuer of securities elects to have a prospectus in the regulated form. It is a criminal offence to seek to offer transferable securities to the public or to seek admission of securities to trading on a regulated market without a prospectus first having been approved by the FSA and then published.[6] There is an offer of transferable securities to the public if there is a communication to any person which presents sufficient information as to the transferable securities to be offered, and the terms on which they are offered, so as to enable an investor to decide to buy or subscribe for the securities in question.[7] Therefore, an offer to only one person will be an offer to the public, unless one of the exemptions applies. The legislative focus is on offers of securities to the public because that is the type of securities transaction, potentially involving non-professional investors, which is the basis of investor protection legislation. By contrast, it is assumed that professional investment managers will be able to assess the risks for themselves and so would not require regulatory protection in the same manner.

It should be noted that a private company – that is, a company which is not a public company[8] – which is limited by shares or limited by guarantee may not "offer to the public any securities of the company" nor "allot or agree to allot any securities of the

[6] Financial Services and Markets Act 2000, s.85.
[7] Financial Services and Markets Act 2000, s.102B.
[8] Companies Act 2006, s.4(1).

company with a view to their being offered to the public".[9] Therefore, offers of securities to the public can only be undertaken by public companies.

Trading on a regulated market

The effect of the Markets in Financial Instruments Directive ("MiFID") will be to level the competition between forums for trading in securities between recognised exchanges, multilateral trading platforms and the activities of "systematic internalisers". As part of the drift towards this broadening of securities markets across the European Union, the regulation of securities markets is now focused on any securities which are traded on "regulated markets" and not simply on "listed securities" (as it was in large part before). A list of "regulated markets" in each jurisdiction is maintained by each competent authority. Consequently, a prospectus is now required whenever securities are to be traded on a regulated market, even if there is no security being offered to the public: which would previously have been the requirement for the publication of regulated documentation to accompany the securities issue.

Prospectuses

The need for a prospectus

As was outlined above, it is a criminal offence[10] under s.85 of the Financial Services and Markets Act 2000 ("FSMA 2000") either to offer transferable securities for sale to the public in the United Kingdom[11] or to request the admission of securities to trading on a regulated market[12] without a prospectus in relation to that issue having first been approved by the competent authority and then having been published.[13] To put the matter the other way around: a prospectus is required for an issue of securities which are to be offered to the public in the UK, and that prospectus must be approved by the Financial Services Authority ("the FSA") before any such offer is made, unless the offer is exempted from this requirement by the terms of the statute.[14] Breach of the duties in s.85 also creates a liability for breach of statutory duty at private law, under s.85(4) FSMA 2000. The requirement for prospectuses since 2005 has replaced the requirement for "listing particulars": listing particulars (under s.79 FSMA 2000) are effectively now only needed in relation to offers of securities to expert investors. An issuer which falls outside the need to publish a prospectus in prescribed form may elect to publish in that form in any event further to s.87 FSMA 2000.

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[9] Companies Act 2006, s.755(1).
[10] Financial Services and Markets Act 2000, s.85(3).
[11] Financial Services and Markets Act 2000, s.85(1).
[12] Financial Services and Markets Act 2000, s.85(2).
[13] Financial Services and Markets Act 2000, s.85, as amended by the Prospectus Regulations 2005 (SI 2005/1433) in the manner discussed in the text.
[14] This is the effect of Financial Services and Markets Act 2000, s.85(1).

The Prospectus Directive

The requirement for prospectuses was enacted further to the Prospectus Directive 2003. There were three objectives of the Prospectus Directive. First, to achieve a single passport for securities issued in one jurisdiction in all other member states in the EU. Secondly, to harmonise the regulation of securities markets in the member states of the EU by means of the single passport regime to which reference has just been made. Thirdly, to achieve an increased level of investor protection by means of the provision of sufficient, suitable information for investors to make informed decisions about their investments.[15] This Directive was implemented by the Prospectus Regulations 2005 and by the FSA Prospectus Rules.

Categories of securities issues not falling within the Prospectus Rules

Schedule 11A to FSMA 2000 provides for three categories of securities which are excluded from the ambit of the term “transferable securities” for the purposes of the offence committed under s.85(1) FSMA 2000.[16] The first category deals generally with government and other public sector securities. The second category relates to securities in not-for-profit organisations. The third category then divides between non-equity securities which are issued in a continuous or repeated manner by a credit institution with a total consideration of less than 50 million euros, and issues of securities with a total consideration of less than 2.5 million euros.[17]

Other exemptions from the requirement to publish a prospectus are set out in s.86 FSMA 2000. First, offers to qualified investors only; secondly, in relation to restricted offers to a small group of target investors; thirdly, in relation to offers of a sufficient size that they are beyond the reach of small investors; fourthly, in relation to large denominations of securities which it would be expected are also beyond the reach of small investors; fifthly, in relation to issues of small amounts with a total consideration of not more than 100,000 euros; sixthly, in relation to a qualified investor acting as an agent; and further categories set out in the Prospectus Rules.

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[15] In turn, to achieve these goals, there is a perceived need for an agreed definition of a “public offer of securities” so that there is a consistent distinction between a public offer and a private placement across the EU. The term “securities” itself does not include sovereign debt securities, but it does cover warrants and covered warrants; cash-settled and physically-settled instruments, as well as shares and debentures in the ordinary way. Underpinning these goals is an underlying policy intended to ensure “investor protection and market efficiency” for securities markets across the EU.

[16] There was previously a set of exempt securities contained in Financial Services and Markets Act 2000, Sch.11, which also contained a gloss on the definition of an “offer to the public” as a result. However, Sch.11 was repealed by the Prospectus Regulations 2005 (SI 2005/1433), reg.2(1), Sch.1, para 16 as from 1 July 2005. It is now Schedule 11A which contains the set of exempt securities, as introduced by the Prospectus Regulations (SI 2005/1433), reg.2(2), Sch.2 as from 1 July 2005.

[17] Financial Services and Markets Act 2000, Sch.11A, para 9(1).

Duty of disclosure

To have a prospectus approved by the FSA, that prospectus must satisfy s.87A(1)(b) FSMA 2000 in that it must contain all the necessary information which investors would require to make an informed assessment of the securities. The necessary information in this context refers to the assets and liabilities, financial position, profits and losses, and prospects of the issuer of the transferable securities and of any guarantor; and the rights attaching to the transferable securities. There is therefore a value judgment to be made by those preparing the prospectus in relation to the information which is required to be provided in this context. The necessary information must be prepared having regard to the particular nature of the transferable securities and their issuer. There is also an obligation to present the necessary information in a form which is comprehensible and easy to analyse. If a significant new factor, material mistake or inaccuracy comes to light after approval of the prospectus but before the trading in the securities begins, then a supplementary prospectus must be published detailing that information.

The contents of a prospectus

The regulations as to the detailed contents of a prospectus are set out in the Prospectus Rules. Those Rules are analysed in Chapter 12 of Alastair Hudson, *Securities Law* (2008).

The basis on which information can be omitted from a prospectus

Assuming a prospectus must be published in relation to a particular issue of securities, it is still open to the FSA to permit the omission of some information from a prospectus in three contexts. Those three contexts relate to three types of information, that is: information the disclosure of which would be contrary to the public interest, information the disclosure of which would be contrary to the interests of the issuer, and information the disclosure of which would be unlikely to influence an informed assessment.

Transparency obligations

The Transparency Obligations Directive[18] created framework rules relating to the flow of information about an issuer to the investing public once securities have begun to be traded on a regulated market. These principles were implemented by Part 43 of the Companies Act 2006 and by the Disclosure and Transparency Rules in the *FSA Handbook*.

The principal aim of the transparency rules is to provide the market with information about who controls the voting power in companies by means of their shareholdings, or

[18] 2004/109/EC.

controlling shareholders, or holding comparable instruments which would enable control of voting power. The bulk of the regulations relate to the issuer, but other people may be required to provide information. First, the issuer must provide the following types of information to the FSA: "voteholder information" at the date of the Directive coming into effect, and subsequent changes in that information; annual and half-yearly accounts, and interim management statements as described in the Directive; information relating to the rights attaching to any and all securities; information relating to any new loans or related security interests connected to them; information as to voting rights held by the issuer in the issuer itself; information as to any proposed amendments to the issuer's constitution. Secondly, investors must provide "voteholder information" to the issuer. Thirdly, the FSA may demand information from the following types of person: the issuer; a voteholder, or a person who controls or is controlled by a voteholder; an auditor of an issuer or a voteholder; or a director of an issuer or a voteholder.

The *FSA Handbook* makes provision in relation to "vote holder and issuer notification rules" in the chapter 5 of the FSA Disclosure and Transparency Rules, in relation to: notification of the acquisition or disposal of major shareholdings; acquisition or disposal of major proportions of voting rights; notification of voting rights arising from holdings of certain financial instruments; aggregation of managed holdings; acquisition or disposal by the issuer itself of shares; disclosures by issuers and notification of combined holdings. Furthermore, the FSA is entitled to demand information from a variety of people in connection with issues of securities.

The concept of "control" of issuers is significant in the transparency of securities issues. The term "control" is defined by s.89J(2) FSMA 2000 so as to include the following categories of person: people who hold a majority of voting rights in other persons, or who have the right to alter the composition of another person's board of directors, or who control the voting rights in another person perhaps by virtue of some shareholders' agreement, or who either have a legal right to exercise a dominant influence over another person or who "actually exercise" a dominant influence over that other person.

Section 90A of FSMA 2000 then provides for liability to pay compensation in relation to any untrue or misleading statement or omission of material relating to annual accounts, half-yearly accounts and interim management statements respectively which should have been provided under the transparency rules.[19] Any person responsible faces liability provided that they knew of the failure to comply with the rules or were reckless as to whether or not there had been compliance.

Listed securities

The official list

The "Official List" is maintained by the Financial Services Authority ("FSA"), when acting in its capacity as the UK Listing Authority ("UKLA"). The Listing Rules created

[19] Financial Services and Markets Act 2000, s.90A(1)(a).

by the FSA apply to securities which are intended to be admitted to the Official List. These securities are referred to as “listed securities”. The penalties for breach of the listing rules are set out in s.91 FSMA 2000

The Listing Principles

The “Listing Principles” properly so-called are a list of principles governing the manner in which issuers and their professional advisors are required to act when complying with the Listing Rules and when dealing with the competent authority. Those Listing Principles imposed on companies whose securities are listed are: the enablement of directors to understand their obligations; the maintenance of adequate procedures, systems and controls; the conduct of activities with integrity; the communication of information so as to avoid the creation or continuation of a false market in listed equity securities; the equal treatment of all shareholders; and the conduct of dealing with the FSA in an open and co-operative manner.

The Model Code

The Model Code is concerned with corporate governance within listed companies as it relates to the misuse of “inside information”. As such it is that part of the Listing Rules which seeks to prevent market abuse, as considered in the next section. Briefly put, during prohibited periods in relation to a company’s securities, any insider (such as a person discharging management responsibilities or an employee in an applicable role) who wishes to deal in that companies securities must seek clearance under the procedure identified in those Rules. The aim is not only to prevent actual abuse but also the prevent the suspicion of abuse, so as to preserve confidence in the market for those securities.

Corporate governance

The Combined Code on Corporate Governance does not create legal obligations but the Listing Rules provide that the annual financial report of a list company must include a statement as to the extent of that company’s compliance with the Code.[20] Also to be included with this statement is a further statement as to whether or not the listed company has complied with the Combined Code throughout the accounting period or whether there are any provisions in relation to which there has not been compliance.

Admission to listing

The procedure for admission to listing requires that an applicant comply with the application procedure set out in the Listing Rules, further to s.75 FSMA 2000. The competent authority may make admission to listing subject to any special condition

[20] Listing Rules, 9.8.6(5)R.

which it considers appropriate. The Consolidation of Admission and Reporting Directive ("CARD") provides that such special conditions should be used "solely in the interests of protecting investors". The basic conditions of the listing rules for admission of securities to listing are set out in Chapters 2 and 3 of the Listing Rules.[21] The general conditions divide between conditions relating to the applicant itself, conditions relating to the nature of the securities which are to be issued, and conditions as to the documentation which is to be provided. There are requirements that the applicant issuer must be duly authorised, have appropriate accounts prepared, have published the prescribed financial information, have appropriate management, have appropriate working capital, and so forth. There are also requirements as to the nature of the securities themselves, which relate severally to the admission of the securities to trading on a recognised investment exchange, the need for the securities to be validly issued and freely transferable, the market capitalisation of the securities, that a sufficient number of securities are to be issued, and the preparation of an appropriate prospectus. Applicants must also have a sponsor who is, in effect, an expert in matters such as admission to listing, who will be required to ensure that the application and its supporting materials are appropriate and suitably prepared.

Powers of punishment held by the FSA

The FSA has four separate powers under FSMA 2000 to prohibit or suspend or otherwise control securities transactions: first, a power to discontinue or to suspend listing further to s.77 FSMA 2000; second, a power suspend or prohibit an offer of transferable securities to the public under s.87K FSMA 2000; third, a power to suspend or prohibit admission to trading on a regulated market under s.87L FSMA 2000; and, fourth, a power to suspend trading in a financial instrument on grounds of breach of the disclosure rules under s.96C FSMA 2000.

Continuing obligations

There are a number of continuing obligations in relation to many aspects of the FSA securities regulations. First, s.87A FSMA 2000 places a duty of disclosure in a prospectus on those people responsible for its production and publication to enable an investor to make an informed assessment of the investment opportunity presented by the securities described in that prospectus.[22] Secondly, transparency obligations, as considered in Chapter 14, relate to the obligations imposed on the issuer of securities and on investors to notify the FSA ultimately about 'voting information' in relation to the control of the company issuing the securities. In a sense this species of regulation is similar to the City Code on Mergers and Takeovers (which is considered in Alastair Hudson, *Securities Law*, Chapter 20 *Takeovers*) in that it seeks to track the ownership and control of public companies. The aim of transparency obligations is to make the control of the company transparent to the investing public. Thirdly, the Listing Rules create a number of rules which can be understood as being continuing obligations: that listed securities must

[21] This gives effect in part to CARD as to shares and as to debt securities.
[22] In relation to listing particulars there is a similar duty of disclosure in s.80 FSMA 2000.

continue to be admitted to trading on a regulated market;[23] that the securities must also remain in public hands as to 25% of their number;[24] that the company must comply with the FSA Disclosure and Transparency Rules – specifically relating to the publication of inside information – while its securities are listed;[25] and that the company is required to comply with the Model Code in the Listing Rules on a continuing basis.[26] Fourthly, the company is required to treat each of its shareholders equally, in accordance with the fifth Listing Principle. Fifthly, by means of the regulation of market abuse, as considered next: in this context, one of the most significant continuing obligations relates to the obligation to disclose inside information under the Disclosure and Transparency Rules such that the issuer must notify a recognised information service "as soon as possible"[27] of any inside information which "directly concerns the issuer".[28]

Market abuse

The regulation of the use of inside information is a key feature of securities regulation. The need to maintain the integrity of securities markets and to ensure fairness between contracting parties in securities transactions are key goals of regulators and legislators alike. The sources of regulation of market abuse in the UK are manifold. Such regulation can be found in: the criminal law (as considered in relation to *Insider Dealing*); the power to impose civil penalties granted to the FSA (as considered in relation to *Market Abuse*); the control of market abuse in the Code on Market Conduct contained in the FSA Market Abuse Rulebook, in "MAR 1"; the regulation of takeovers and mergers when price sensitive information surrounding a possible bid abounds; and the Model Code in the Listing Rules and the FSA Disclosure and Transparency Rules.

The FSA created the Code on Market Conduct ("MAR 1") further to s.119 FSMA 2000. Section 118 FSMA 2000 sets out the categories of behaviour which constitute market abuse, and then MAR 1 provides detail as to the FSA's attitude to those various categories. The three categories of market abuse arise under the FSA rulebook "MAR 1": when a person is "dealing on the basis of inside information which is not trading information";[29] when an insider discloses information to another person; and when a person fails to observe proper market conduct when dealing with price sensitive information which is not in the public domain.

[23] Listing Rules, 2.2.3R.
[24] Listing Rules, 6.1.19R
[25] Listing Rules, 9.2.6R.
[26] Listing Rules, 9.2.8R.
[27] This will be satisfied if the issuer acted as soon as was possible in the circumstance of factors which were only gradually coming to light: Disclosure and Transparency Rules, Chap. 2, para, 2.2.2R. A short delay in publication of the information will be acceptable if it is "necessary to clarify the situation": Disclosure and Transparency Rules, Chap. 2, para, 2.2.9G.
[28] Disclosure and Transparency Rules, Chap. 2, para, 2.2.1R.
[29] MAR, 1.3.2(1)E.

Liability to pay compensation for untrue or misleading statements or omissions in a prospectus

Persons responsible for the prospectus

The FSA Prospectus Rules provide for the categories of person who are deemed to be responsible for the contents of a prospectus in relation to equity shares, warrants or options to subscribe for equity shares, or other transferable securities of similar kind.[30] Paraphrasing those categories from Prospectus Rules, para 5.5.3R:[31] the issuer; directors and those authorising themselves to be named as responsible for the prospectus; Each person who accepts responsibility for the prospectus; in relation to an offer, each person who is a director of a body corporate making an offer of securities; in relation to applications for admission to trading, each person who is a director of a body corporate making an offer of securities; and other persons who have authorised the contents of the prospectus. It is possible for individuals, advisors or companies to limit their liabilities by refusing to accept responsibility for part or all of the particulars. Liability for losses suffered by investors will therefore be borne by these people in the manner discussed below.

Liability for damages for contravention of a rule: s.150 FSMA 2000

There is a right to recover damages under s.150 FSMA 2000 in the following circumstances: "[a] contravention by an authorised person of a rule is actionable at the suit of a private person who suffers loss as a result of the contravention". This does not include matters covered by s.90, considered next.

Liability to pay compensation under s.90 FSMA 2000

Any person responsible for a prospectus is liable to pay compensation to a person who has acquired securities to which the prospectus applies; and who suffered loss in respect of them as a result of any untrue or misleading statement in the prospectus or as a result of the omission from the prospectus which should have been included under the duty of disclosure. A number of defences are then provided in Sch.10 to FSMA 2000 relating to the defendant's belief in the truth of the statement, or relying on a statement by an expert or a statement in an official publication, or relating to an attempt to publish a correction.

Liability for misrepresentations under the general law

Liability exists at common law for the tort of deceit, for the tort of negligence under *Hedley Byrne v Heller* for negligent misstatements, for fraudulent misrepresentation under contract, and for negligent misstatement under contract. These heads of liability are

[30] Prospectus Rules, para 5.5.3R.
[31] Prospectus Rules, para 5.5.3R.

considered in detail below, including analyses of the particular cases relating to offers of securities. The old cases took the view that people preparing a prospectus are "are bound to state everything with strict and scrupulous accuracy", and so liability for damages or for rescission at common law was predicated on this principle: a principle which, it is suggested, can be found in similar (if milder) form in the prospectus rules. Thus half-truths and ambiguous statements will attract liability at common law as much as outright lies (albeit that the former may be negligent while the latter will be fraudulent). The reader is referred to Chapter 24 of *Securities Law* for a detailed consideration of each head of claim.

Penalties

There are a variety of types of penalty for breaches of securities regulation. In relation to listed securities, the penalties associated with cancellation and suspension of listing are discussed in Chapter 15 of this book. Censures of sponsors may be issued in relation to listed securities; a company may be publicly or privately censured further to s.87M and s.91 FSMA 2000. The principal provision governing penalties for breach of FSA securities regulation is s.91 FSMA 2000, which may open the company up to a fine and may also open any director of the company who was knowingly concerned up to a breach up to a fine. The appropriate penalties for breach are considered in the discussion of the relevant obligations through Part 4 of *Securities Law*.

Criminal law

The criminal law relating to securities is principally concerned with market abuse in relation to the criminal offences relating to insider dealing under Part V of the Criminal Justice Act 1993 and the offences relating to market manipulation under s.397 of FSMA 2000. There are three offences relating to insider dealing. In relation to insider dealing, the principal focus of the offence in s.52(1) CJA 1993 is on individuals who deal in "price-affected" securities using information which they gleaned as an insider. The second offence relates to encouraging others to deal in price-affected securities. The third offence relates to disclosing inside information. There are then a range of defences to these offences. In relation to market manipulation, the activities which constitute these offences are where a person makes a statement, promise or forecast which "he knows to be misleading, false or deceptive in a material particular"[32] or where a person creates a false or misleading impression as to the market.[33]

Under the criminal law there are also offences relevant to securities transactions under various provisions of the Theft Acts and the Fraud Act 2006; as well as the offences which are created under FSMA 2000 of relevance to securities transactions, dealing severally with the restriction on financial promotion, the publication of prospectuses and so forth.

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[32] Financial Services and Markets Act 2000, s.397(1)(a).
[33] Financial Services and Markets Act 2000, s.397(3).

Allotment of shares

There is a detailed code dealing with the rules on allotment of shares. The provisions concerning directors' authority to allot shares are encapsulated in the general principle in s.549 CA 2006. That provision is expressed as a general prohibition on the allotment of shares or the grant of rights to subscribe for shares, with exceptions permitting the allotment of shares or the grant of rights to subscribe for shares. Those exceptions then grant different rights for the directors to allot securities in relation to different forms of company if, for example, there are appropriate powers in the company's constitutional documents. The allotment code contains a right for existing shareholders of pre-emption such that voting power and the proportion of each shareholder's holding of the company's equity cannot be diluted without first offering new shares to existing shareholders. There are also important controls on the way in which payment can be made for shares, with the aim being to prevent shares being issued at a reduced consideration in a way which would alter the composition of the shareholdings in the issuing company without increasing the size of its equity capital to the same extent. The detail of these rules is beyond the scope of this course.

Chapter 1.

Introduction

Securities law within the law more generally

The components of securities law: securities regulation and the general law

"Securities law" is a fusion of securities regulation, of statutes aimed specifically at securities transactions, and of the general law of England and Wales as it relates to securities transactions. It is a topic which I discussed in detail in my book *Securities Law*.[34] Securities law is part of the law of finance in that the general principles underpinning financial services regulation in the UK also underpin securities regulation.

There are then regulations which deal specifically with securities, which are referred to here as *securities regulation*. Therefore, securities regulation can be thought of as a sub-set of *financial regulation* in that it is governed, first, by general financial regulation and, secondly, specifically by securities regulation. Securities regulation is a system of rules derived ultimately from a group of EC securities directives which govern the manner in which securities may be offered to the public or admitted to trading on regulated markets in the European Union, and the information which must be provided by the issuer and its professional advisors at the time of issue and on a continuing basis thereafter.

These principles create "securities regulation" whereby the competent authority in each member state of the European Union is responsible for the regulation of offers of securities to the public in the manner described below. Securities regulation can therefore be thought of as a tier of regulation which takes the general principles of financial regulation and applies them in a particular context, in common with regulations which have been prepared specifically for the context of securities transactions.

Securities *law* is not only made up of securities regulation, however, but rather is also comprised of the general law of England and Wales, principally contract law, tort law and equity, and also some statutes enacted specifically to deal with securities transactions (such as the criminalisation of insider dealing by the Criminal Justice Act 1993). Of course, the bulk of the general law does not deal with securities transactions specifically, and therefore the concepts of general law must be translated to the securities law context as with any other contextual analysis of English law.[35] Nevertheless, there are aspects of private law liability which are specific to securities business, having been created by the Financial Services and Markets Act 2000 ("FSMA 2000").[36]

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[34] Alastair Hudson, *Securities Law* (Sweet & Maxwell, 2008), 912pp.
[35] Securities regulation, however, as distinct from the general law relating to securities, applies to the entire United Kingdom as a result of its derivation from the law of the European Union.
[36] For example, s.90 and s.90A FSMA 2000.

CHAPTER 2.

THE "LAMFALUSSY" PROCESS

There was a perception in the EEC (as it then was) that a large obstacle to the economic development of the Community was the absence of a single market for capital. In many European countries, companies relied almost primarily on bank debt for economic activity and there was a comparative lack of finance being raised through the issue of securities. Therefore, the Community sought to develop a single market for capital by breaking down the barriers between Member States. The beginnings of a serious legislative movement towards the modernisation of securities regulations in the Community can be identified in the Investment Services Directive of 1993[37] ("ISD"),[38] but the ISD could not keep pace with the rate of change in securities markets and so quickly went out of date. Market practice since the passage of the ISD in 1993 saw an explosion in the electronic trading of securities, great developments in trading platforms operated off-exchange, the growth of over-the-counter derivatives and securitisation products, and a large number of securities-related corporate governance scandals. Consequently, the markets changed rapidly very soon after the implementation of the ISD.[39] It required the Financial Services Action Plan ("FSAP") of 1999[40] to reinvigorate the legislative agenda. The principal concern was that the lethargy in the production of adequate, harmonised securities regulation across the EEC was due in the part to the slowness with which directives were produced when compared to the pace of change in the securities markets themselves.

In the wake of the FSAP, the so-called "Committee of Wise Men", chaired by Belgian central banker Baron Alexandre Lamfalussy, produced its final report in February 2001 (generally known as "the Lamfalussy Report")[41] which, *inter alia*, suggested a new methodology for the creation of EC directives in the securities field. The Lamfalussy process is at the heart of modern securities regulation in the EU, and created what was become known as the Lamfalussy methodology for enacting securities regulation in the EU in the future. This new methodology is comprised of four levels of legislation: namely framework principles, implementing measures, cooperation, and enforcement. The key to this methodology was to simplify the principal legislation in the form of high-level directives which set out the general, framework principles on which the regulation is based, and then the inclusion of the more detailed principles in Technical Regulations to be published by the Commission.

The first level identifies framework principles which are to be provided in the securities directives and the second level leaves it to the Commission to create implementing measures and detailed regulations dealing with more technical matters. It is expected that, unlike the rapid ossification of the purposes underlying the ISD of 1993, in the

[37] Directive 93/22/EEC ([1993] OJ L141/27).
[38] This directive has since been superseded by the Markets in Financial Instruments Directive 2004.
[39] This directive has now been displaced by MiFID, as implemented in 2007.
[40] COM (1999) 232.
[41] Named after the Baron Lamfalussy who chaired this committee.

future directives could respond more nimbly to changes in market practice without the need for root-and-branch reform; unlike the old style of directive before the Lamfalussy process was created which was comprised of more detailed rules which were susceptible to going out of date more quickly. The third tier of legislation encapsulates guidance from the Committee of European Securities Regulators ("CESR") which seeks to ensure uniform implementation of the framework principles and the technical material by the competent authorities of each Member State. CESR is a committee comprised of central bankers who are able to talk to market conditions at any given time and therefore to guide the policy of the EU more accurately. The fourth tier of regulation is an enforcement mechanism which is effected by the Commission. Co-operation between regulators across the EU then ensures even enforcement across the EU.

CHAPTER 3.

EC SECURITIES REGULATION

The policy underpinning EC securities regulation

The securities directives have developed the following principal policy objectives. First, the creation of efficient markets so that companies are able to access liquid capital by means of issuing securities and so that there are securities markets available to investors. Secondly, to ensure investor protection in these securities markets. This second policy has not been dealt with as well by European legislation at present in relation, for example, to conduct of business regulation: consequently, it has frequently been a matter for regulation by the competent authorities of member states. However, the implementation of the Markets in Financial Instruments Directive 2004 ("MiFID") promises to prompt seismic changes in conduct of business regulation across the EU, even in jurisdictions such as the UK in which conduct of business had previously been rigorously provided for in FSA regulation.

These policy objectives are based on two assumptions. First, a perception that the securities markets in the EU are too fragmented. Secondly, a determination embodied in the Financial Services Action Plan that the different strands of securities regulation practised previously in each separate Member State across the EU required harmonisation. What is at issue is the manner in which this objective of harmonisation has been pursued. Let us be clear about what it does not mean. The general law which may affect securities markets – such as contract law, tort law, fiduciary law, and so forth – is not to be harmonised: therefore, the contract law of each Member State will remain idiosyncratically the contract law of each Member State, and so on. Rather, it is the regulation of securities by the competent regulatory authority of each Member State which is to be harmonised; and other issues – such as the criminalisation of insider dealing and the provision of a right to compensation in certain circumstances – which have been required by EC directives. In relation to those matters which are to be harmonised, however, there are questions as to the extent to which there has actually been any harmonisation at all. This question requires a little attention.

The word "harmonization" could mean either "equalization", in the sense of making all of the securities regulation of each Member State exactly the same; or merely "approximation", in the sense of bringing those securities regulations closer together without needing to make them identical. The EU has only achieved "approximation" through the establishment of minimum standards of regulation across the EU precisely because the securities directives grant Member States the power to create more stringent rules than are contained in the directives. However, with the detail of the Commission's Technical Regulations it is not only at the framework level that EC securities regulation has been brought closer together across the EU. In the Consolidated Admission and Reporting Directive ("CARD") the legislative objective is to promote the "co-ordination" of the securities laws of member states, as opposed to requiring their "harmonisation". The municipal implementation of the directive in member states requires the implementation of minimum standards, as opposed to the equalization of standards. Thus CARD's implementation takes account of "present differences in the structures of securities markets in Member States"[42] so as to enable member states to take into account "any specific situations with which they may be confronted";[43] and so "co-ordination should first be limited to the establishment of minimum conditions".[44] The means by which the competent authorities of Member States give effect to the Transparency Obligations Directive can be "subject to requirements more stringent than those laid down" in the Directive.[45] This process of imposing more stringent requirements is known colloquially in the markets as "gold-plating".

Passporting issues of securities

Rather than require that all securities regulations across the EU are equal, what has been provided for instead in the securities directives is that an issue of securities which has been authorised for admission to listing in one Member State can automatically be admitted to listing in any other Member State. In the jargon, this is known as granting that issue a "passport" to be issued as of right in all Member States of the EU. This has become the key means by which a single market for securities is to be effected, by permitting a security authorised in one jurisdiction to be effectively authorised in another jurisdiction; although this is not the same as having a single market for securities which operates identically in all jurisdictions. Thus, the distinction between the laws of different Member States remains, although their securities regulations are required to have the same minimum standards. Equally, the ability of jurisdictions to "gold-plate" their regulations means that admission to trading in one jurisdiction may be demanding than admission to trading in another jurisdiction. Significantly, however, no discrimination can be permitted between the way in which any given jurisdiction deals with applications for authorisation between issues originating in its own jurisdiction or issues seeking to be passported from another jurisdiction.

The macroeconomic policy underpinning securities regulation; and the importance of information

Securities regulation in the EU is based on macroeconomic objectives to do with the development of a viable, single market for securities which is understood by potential investors as protecting their interests. The enthusiasm for a single capital market is itself predicated on a perception that a viable, liquid market for capital without obstacles will encourage economic activity. These underlying assumptions are made clear in the directives. For example, in the first recital to the Transparency Obligations Directive provides that:

> 'Efficient, transparent and integrated securities markets contribute to a genuine single market … foster growth and job creation by better allocation of capital and by reducing costs. The disclosure of accurate, comprehensive and timely information … builds sustained investor confidence and allows an informed

[42] CARD, recital 5.
[43] *Ibid*.
[44] CARD, recital 6.
[45] Transparency Obligations Directive, art. 4(1).

> assessment of their business performance and assets. This enhances both investor protection and market efficiency.'

These goals are to be achieved by means of '…transparency for investors through a regular flow of information',[46] whilst communicating with investors who own shares with voting rights about changes in the company's major holdings. The requirement for proper information to be provided to investors is considered in Chapter 40 *Prospectuses and transparency obligations* in relation respectively to the regulatory requirement that a prospectus in approved form accompanies any issue of securities (so that minimum levels of information are made available to the market) and to the requirement that issuing companies make enough information known to the market as to who owns controlling interests in its securities. It is through "harmonisation" of regulations dealing with these species of information that it is expected that an appropriate level of protection of those investors can be maintained.[47] The removal of barriers within and between Member States relating to issues of securities is to be effected by displacing national rules with Community-wide rules.[48]

The six EC Directives relating to securities

There are six EC Directives which are of relevance to public issues of securities. First, the Consolidated Admission and Reporting Directive of 2001[49] which consolidates, as its name suggests, the principles in an earlier slew of directives. Secondly, the Prospectus Directive[50] which was implemented by means of the new listing rule arrangements effected by the FSA as of 1st July 2005. Thirdly, the Transparency Directive[51] which was implemented in the UK in 2007 by Part 43 of the Companies Act 2006. These three directives are referred to here as the "securities directives", and are considered in outline in turn in the following sections. The two other directives relate to financial matters more generally but they have great bearing on securities markets. Fourthly, then, is the Market Abuse Directive, dealing with inside information and so forth, implemented in 2005; and, fifthly, the International Accounting Standards Directive, implemented in 2005 relating to the form of accounting information provided by companies. Finally, MiFID governs the whole of financial services activity. It would worthwhile first to consider the development in principle of the EC legislation in this context, given that the recent directives were developed as a result of recent policy developments.[52] Each directive is considered in turn.

The Consolidated Admissions and Reporting Directive

The structure of CARD

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[46] Transparency Obligations Directive, recital 2.
[47] Transparency Obligations Directive, recital 5.
[48] Transparency Obligations Directive, recital 9.
[49] Council Dir. No. 2001/34/EC.
[50] Directive 2003/71/EC (2003 OJ L 345).
[51] Directive 2004/109/EC (2004 OJ L 390).
[52] See N Moloney, *EC Securities Regulation* (Oxford University Press, 2002), 1-53.

The Consolidated Admissions and Reporting Directive[53] ("CARD") consolidated four earlier "listing directives". CARD itself has been amended by a number of later EC securities directives.[54] Not all issues of securities are covered by CARD. Rather, CARD is limited to "admission to official listing on a stock exchange",[55] as opposed to private offerings or issues of securities in general terms outside the official list.

The co-ordination objective

CARD takes account of "present differences in the structures of securities markets in Member States"[56] so as to enable member states to take into account "any specific situations with which they may be confronted".[57] Thus "co-ordination should first be limited to the establishment of minimum conditions":[58] so there is no objective making all laws the same, but rather ensuring that they are based on a minimum level of regulation in all Member States that would permit the movement of approvals to be passported in time between Member States. The directive is concerned to achieve "closer alignment" of national regulatory rules,[59] through a "first step" which led to the Prospectus Directive and the Transparency Directive. One of the principal misalignments between different national systems of securities regulations are the "safeguards" for investor protection in those different codes. CARD is intended to eliminate them by "coordinating the [various national] rules and regulations without necessarily making them completely uniform".[60]

The detailed policies: passporting and investor protection in CARD

There are two underlying policies in CARD beyond the coordination of laws. First, mutual recognition in all member states of any authorised listing of securities in the issuer's home member state.[61] This is the "passport" granted to such securities which enables a security admitted to listing in member state *x* to be admitted to listing as a result in member state *y*. Secondly, "to ensure that sufficient information is provided for investors".[62] The provision of information is to be achieved by making accounts available, principally by means of making annual reports and other information available to investors, with some exceptions in relation to debentures.

There were three results which were expected to flow from the implementation of CARD. First, the improvement of investor protection. This was intended principally to arise from issuers being required to make information available to investors. Secondly, an increase in investor confidence, principally by virtue of requiring issuers of listed securities to bear continuing obligations to provide identified classes of information to the investing public and so reassuring investors about the efficacy of the information available to them. Thirdly, ensuring that securities markets function correctly. As for the more general

[53] 2001/34/EC. Hereafter "CARD".
[54] Principally 2003/6/EC, 2003/71/EC, 2004/109/EC, and 2005/1/EC, as considered in the text to follow.
[55] CARD, art. 1(a) and art.2.
[56] CARD, recital 5.
[57] *Ibid*.
[58] CARD, recital 6.
[59] CARD, recital 7.
[60] CARD, recitals 9 to 11.
[61] CARD, recital 13.
[62] CARD, recital 21.

viability of the mooted pan-European market in securities, CARD provides that its expectation "by making [investor] protection more equivalent" is that "coordination of that policy at community level is likely to make for greater inter-penetration" of securities markets.[63] That is, by generating a greater equivalence between national securities regulations it is hoped that issuers and investors will be prepared to act across borders within the EU.

The detailed provisions of CARD still in effect in relation to admission of securities to official listing are discussed in detail in chapter 38.[64]

The Prospectus Directive

The general purpose behind the Prospectus Directive 2003

The Prospectus Directive is concerned with the approval of a prospectus by the competent authority in any given Member State prior to the admission of securities to listing and to the admission of securities to trading on a regulated market. The Prospectus Directive creates the core principles on which the FSA Prospectus Rules are based. The Prospectus Directive was implemented in the United Kingdom by amendment to the FSMA 2000, which was done by means of a statutory instrument known as the "Prospectus Regulations 2005", and by the creation of the FSA Prospectus Rules. The FSA Prospectus Rules also implemented the Commission technical regulations in relation to this Directive.

In short the Prospectus Directive furthers the over-arching policy objective of creating a single internal market for the EU.[65] The directive's particular objective is to coordinate earlier directives and to replace those earlier directives so as to achieve the single passport for securities issues.[66] The rules relating to the requirement for and publication of prospectuses are concerned with the minimum contents of the prospectus which is to be published when securities are to be offered to the public or are to be admitted to trading on a recognised exchange, to facilitate the mutual recognition of prospectuses so that issues of securities can be offered to the investing public across the EU, and thus to facilitate the creation of a viable Europe-wide securities market with (as the bureaucratic metaphor has it) "deep, liquid pools of capital". Each of these facets is considered in outline below.

The single passport regime within the Prospectus Directive

The Prospectus Directive[67] was as an "instrument essential to the achievement of the internal market" as part of the Risk Capital Action Plan. This move towards the internal market is to be effected in part by the provision of a single passport to each issue of securities so that its authorisation by the competent authority in one member state shall

[63] CARD, recital 32.
[64] See para 11-03.
[65] PD, recital (4).
[66] PD, recital (1).
[67] 2003/71/EC.

be recognised in all other member states.[68] The “country of origin” principle, considered below, has the effect that, in relation to an offer of securities which is to be made across borders within the EU, the regulator from the issuer’s home member state is the one best placed to regulate that issue.[69]

The definition of the “public offer of securities”

Among the problems identified by the Lamfalussy Report which are addressed by the Prospectus Directive is the lack of a common definition of the term “public offer of securities” across the EU.[70] The directive also encompasses a wider scope of “securities” than hitherto, including cash-settled securities generally, covered warrants and non-equity securities. The requirement that the securities are intended to be admitted to trading on a regulated market may cover issues of securities which are not intended to be offered to the public. Thus, even a private placement of shares will fall within the requirements of the directive if those shares are to be admitted to trading on a regulated market. This is a significant broadening of the principles contained in the previous listing regime because it is not concerned solely with issues offered to the public generally but rather it is concerned to protect the integrity of all regulated markets whether or not the securities are not offered to the public initially.

The publication requirements under the Prospectus Directive

A prospectus must be approved and published before an offer is made to the public or before a request is made to admit securities to trading on a regulated market. These requirements are considered below.

Enhancement of investor protection under the Prospectus Directive

The provision of sufficient and suitable information for investors is a key plank of investor protection under the Prospectus Directive. The issuer bears an “ongoing disclosure obligation” to make “reliable information” available to the investing public throughout the life of the security.[71] The bulk of the Prospectus Directive is therefore concerned to sculpt the best means for the preparation and publication of suitable prospectuses. To achieve this end the directive borrows from the IOSCO standards in an effort to give effect to “best practices” in EC securities markets.[72] The procedures for the authorisation of a prospectus, and the time limits within which those procedures are to be performed, are set out in the directive. Differences of detail between national laws are permitted provided that they do not discriminate between issuers. It is anticipated, however, that such “differences should be eliminated by harmonising the rules … to achieve an adequate degree of equivalence of the safeguards [for investor protection by means of] provision of information”.[73]

[68] Prospectus Directive (“PD”), recital 4.
[69] PD, recital 14.
[70] PD, recital 5.
[71] PD, recital 27.
[72] PD, recital 22.
[73] PD, recital 30.

The policy underpinning the Commission's technical regulation on prospectuses

The Prospectus Directive a provides a list of principles which are to guide the preparation of the Commission's technical regulation, namely:

> '- the need to ensure confidence in financial markets among small investors …;
> - the need to provide investors with a wide range of competing investment opportunities and a level of disclosure and protection tailored to their circumstances;
> - the need to ensure that independent regulatory authorities enforce the rules consistently, especially as regards the fight against white collar crime;
> - the need for a high level of transparency …;
> - the need to encourage innovation in financial markets if they are to be dynamic and efficient;
> - the need to ensure systemic stability of the financial system by close and reactive monitoring of financial innovation;
> - the importance of reducing the cost of, and increasing access to, capital;
> - the need to balance, on a long-term basis, the costs and benefits to market participants … of any implementing measures;
> - the need to foster the international competitiveness of the Community's financial markets without prejudice to a much-needed extension of international cooperation;
> - the need to achieve a level playing field for all market participants by establishing Community legislation every time it is appropriate;
> - the need to respect differences in national financial markets where these do not unduly impinge on the coherence of the single market;
> - the need to ensure coherence with other Community legislation in this area, as imbalances in information and a lack of transparency may jeopardise the operation of the markets and above all harm consumers and small investors.'[74]

This statement of principle is a development peculiar to the more recent generation of financial legislation in the EU. Four features are worthy of note. First, there are prudential objectives to maintain the financial system and to ensure investor protection. Secondly, there are commercial objectives to make access to capital cheaper and easier by evening out some of the key differences between financial regulation in various member states. Thirdly, to dilute the earlier objective of harmonising regulation across the EU and instead to move towards it gradually by first recognising valid differences between securities markets in various member states and then, in effect I would suggest, by removing the obstacles to future harmonisation. Fourthly, a genuinely European identity is observable in the determination to ensure the competitiveness of the Community's financial markets and to respect the Community's role within the larger context of international regulatory initiatives.

The continuing importance of domestic law

[74] PD, recital 41.

Sanctions for breach of these regulations are to be provided by means of municipal substantive law and regulation, rather than by some European mechanism.[75] Similarly, it is a requirement that there be appeal from any decision of a national, regulatory authority within national law, and that there be a right of "judicial review" from such decisions.[76] Thus, it is clear that it is a question for national law as to what exactly happens once there has been a breach of any regulatory principle, let alone in relation to any claim for compensation any loss suffered by reference to the municipal law of that member state.

The Transparency Obligations Directive

The general principles underpinning the Transparency Obligations Directive

The Transparency Obligations Directive was implemented in the UK by Part 43 of the Companies Act 2006 and by means of the introduction of new "Disclosure and Transparency Rules" to the *FSA Handbook*.[77] The Transparency Obligations Directive is concerned primarily with the provision of sufficient information to investors in the securities markets. It is expected that markets will become "transparent" when sufficient information is made available to the public so that nothing is opaque or obscure. As the Directive provides:

> 'This Directive establishes requirements in relation to the disclosure of periodic and ongoing information about issuers whose securities are already admitted to trading on a regulated market situated or operating within a Member State.'[78]

The Transparency Obligations Directive is concerned with the disclosure of information in relation to securities which have already been issued and therefore with obligations to maintain levels of information affecting the securities after issue. Much of the directive, as is discussed below, is concerned with the provision of appropriate forms of financial information and with information on an on-going basis about the voting control of the issuing entity.

Obligations to publish information under the Transparency Obligations Directive

The Transparency Obligations Directive imposes obligations on issuers of securities and on other "persons responsible" to publish a variety of types of information so that prospective investors in those securities will be able to make informed decisions based on this statutorily-defined minimum amount of information. That information falls broadly into two types: financial information and information about shareholdings in the issuer. Issuers are obliged to publish annual financial reports and half-yearly financial reports (the latter containing a condensed set of financial statements, an interim management report and similar statements) so that there is more timely and more reliable information available to the investing public, so that the information given constitutes a true and fair

[75] PD, recital 43.
[76] PD, recital 44.
[77] Transparency Obligations Directive, art. 31(1).
[78] Transparency Obligations Directive, art. 1.

view of the state of the issuer.[79] The Member States are then obliged to ensure that those responsible people are suitably liable within the private law of their municipal legal systems. Secondly, information relating to changes in major shareholdings in the issuer are to be included in the material which must be made known to the public;[80] in particular changes in voteholder control which cross a series of statutorily defined thresholds.

Implementation of the policies underpinning the Transparency Obligations Directive in Member States: "gold-plating"

The means by which the competent authorities of Member States give effect to this Directive can be "subject to requirements more stringent than those laid down" in the Directive.[81] However, it is important to note that it is only when acting as the "home Member State" that the competent authority may impose more stringent requirements; by contrast if that competent authority is dealing with an issue of securities which has already been authorised by the competent authority of another Member State (so that that competent authority is the "host Member State" rather than a home Member State) then the competent authority of the host Member State may not impose more stringent requirements on those securities which have been authorised elsewhere.[82]

MiFID and trading on regulated markets

The effect of the Markets in Financial Instruments Directive ("MiFID") is to level the competition between forums for trading in securities between recognised exchanges, multilateral trading platforms and the activities of "systematic internalisers".[83] As part of the drift towards this broadening of securities markets across the European Union, the regulation of securities markets is now focused on any securities which are traded on "regulated markets" and not simply on listed securities. A list of regulated markets in each jurisdiction is maintained by each competent authority. Consequently, a prospectus is now required whenever securities are to be traded on a regulated market, even if there is no security being offered to the public: which would previously have been the requirement for the publication of regulated documentation to accompany the securities issue.

[79] Transparency Obligations Directive, art. 4.
[80] Transparency Obligations Directive, art. 9.
[81] Transparency Obligations Directive, art. 4(1).
[82] Transparency Obligations Directive, art. 4(2).
[83] See para .

CHAPTER 4.

PROSPECTUSES

THE IMPORTANCE OF INFORMATION

Information is key to securities markets. Both professional and lay investors rely on information about companies in which they may seek to invest – especially information relating to their prospects, their businesses, market sentiment about their markets, and so forth – and therefore securities regulation focuses in large part on the regulation of information. The principal means by which securities law has always sought to regulate the issue of securities is by requiring that suitable amounts of information are given to investors in the form of a *prospectus*. Prospectuses have long been a feature of dealings in shares and other securities. Even the old nineteenth common law dealt with statements in prospectuses. The case law has since been replaced by formal regulation by the Financial Services Authority ("FSA") as to the contents of prospectuses and the need to keep the investor community appraised of updated information relating to that prospectus, as considered below.

Information is also important, as considered later in these materials, in relation to transparency obligations after the securities have been issued and in relation to insider dealing. Also of great importance in relation to information is the criminal law prohibiting *insider dealing* and *market abuse*, considered below.

PROSPECTUSES

The fundamental principles of the regulation of prospectuses

The prospectus as the principal means of providing information to investors

Securities law is concerned with the provision of enough of the right sorts of information to the investing public to enable potential investors to make informed decisions about their investments. It does not seek to protect investors against the possibility of loss; nor does it seek to protect investors against their own folly. Instead having sufficient information to make an informed decision places the onus for making investment decisions onto the investor. The principal means by which information is provided to investors is by a prospectus; or on certain occasions in relation to expert investors by means of a document known as "listing particulars" (although in this chapter we will concentrate on the more important regime dealing with prospectuses). The Prospectus Directive of 2003[84] is the securities directive which set out the high-level principles governing the regulation of prospectuses. The regime which it created applies to offers

[84] 2003/71/EC.

of transferable securities to the public and to applications for admission of securities to trading on a regulated market.

The new regime of prospectus regulation under the Prospectus Regulations 2005

In 2005 the UK Prospectus Regulations[85] implemented the EC Prospectus Directive by means of amending existing sections of Part 6 of FSMA 2000 and also by introducing new sections to that Part 6. The UK Prospectus Regulations 2005 ("the Prospectus Regulations 2005") repealed the Public Offers of Securities Regulations 1995[86] (which had previously dealt with unlisted securities) and also repealed the Financial Services and Markets Act 2000 (Official Listing of Securities) Order 2001[87] (which had previously dealt with offers of listed securities). The Prospectus Regulations 2005 completely changed the manner in which prospectus material is to be prepared and the legal principles governing prospectuses, as required by the EC Prospectus Directive. Before the Prospectus Regulations 2005 were introduced, it had been important to know whether securities were to be listed on the Official List or were to be unlisted so that one could identify which regulatory code would deal with those securities.

Instead, after July 2005 for the purposes of prospectus regulation, as a result of the Prospectus Regulations 2005 it is now important to know whether securities are to be offered to the public, or whether they are to be the subject of a request for admission to trading on a regulated market; or alternatively whether the offer falls outside either of these categories, or is an exempt offer under the prospectus regulations. These categories of offer of securities will be considered below. (The only sense in which it is now important to know whether securities are listed or unlisted is so that one can know whether or not the FSA Listing Rules will apply to those securities.)

The principles of the FSA Prospectus Rules

The genesis of the Prospectus Rules

The detailed regulation of prospectuses generally is set out in the FSA Prospectus Rules ("the Prospectus Rules"), which form part of the *FSA Handbook* and which are one of the key parts of securities regulation in the UK. The Prospectus Rules were created by the FSA under powers granted to it by s.84 of FSMA 2000. The bulk of the Prospectus Rules is made up of the provisions of the Commission's technical regulation which fleshes out the detail of the high-level principles in the Prospectus Directive 2003, in line with the Lamfalussy methodology for securities regulation.

The applicability of the Prospectus Rules beyond listed securities

For the regulations relating to prospectuses to apply the securities in question do not have to be admitted to the Official List nor do they have to be the subject of an application for admission to the Official List. It is sufficient for a prospectus to be

[85] S.I. 2005/1433.
[86] S.I. 1995/1537
[87] S.I. 2001/2958. Also revoked are the Financial Services and Markets Act 2000 (Official Listing of Securities) Regulations 2001 (S.I. 2001/2956).

required, and thus for the regulations dealing with prospectuses to apply, that those securities are the subject of a request for admission to trading on a regulated market. The effect of requiring prospectuses to be prepared and published in an approved form in relation to any securities which are the subject of an application for admission to trading on a regulated market is that the prospectus regulations will now apply even to such offers which would previously have been exempted from the need for a prospectus.

The amount of professional work which is bound up with the preparation of a prospectus – involving lawyers, accountants, investment bankers, and others – is enormous and the costs are therefore commensurately high. The prospectus regulations are both detailed and yet also governed by high-level principles of disclosure and integrity, with extensive obligations to pay compensation for any loss suffered as a result of an untrue or misleading statement in the prospectus.[88] Consequently, the widening of the ambit of prospectus regulation across the EU in 2005 (with the implementation of the Prospectus Directive) has increased the costs associated with various kinds of securities issues which were previously exempt from this sort of regulatory scrutiny.

What is a prospectus?

A prospectus, broadly defined, is a document which makes prescribed forms of information about securities and about their issuer available to the investing public. That prospectus will therefore constitute a series of representations on which purchasers of those securities will rely when making the decision whether or not to acquire them. The prospectus is therefore the root of any contract for the acquisition of securities, and consequently the approach of securities regulation in this context has been to prescribe the minimum contents of a prospectus for certain types of issuer and for certain types of security, and to demand the continued accuracy of that prospectus during its lifetime so that the investing public is provided with sufficient, appropriate material with which to make informed investment decisions. This section, then, considers both the requirements for a prospectus, the circumstances in which a prospectus will not be required, the continuing obligations associated with prospectuses and the required contents of such a prospectus.[89]

That this section only considers offers of transferable securities to the public or requests for admission of securities to trading on a regulated market

The regulations considered here relate only to an offer of transferable securities to the public[90] or a request for admission of securities to trading on a regulated market[91]. The

[88] Financial Services and Markets Act 2000, s.90.
[89] The old definition of "prospectus" in the Companies Act 1985, s.744 required the offer to be "for subscription or purchase". In *Government Stock and Other Securities Investment Co Ltd v. Christopher* [1956] 1 W.L.R. 237 Wynn-Parry J. interpreted that definition as being inapplicable to a circular by a take-over bidder to the target company's shareholders offering shares in the bidder (yet to be allotted) in exchange for shares in the target company. It was not an offer for the "purchase" of shares ((as they were by then unissued *Re VGM Holdings Ltd* [1942] Ch. 235) nor was it an offer for "subscription" (as that was taken to connote taking shares for cash (on which see *Arnison v. Smith* (1889) 41 Ch.D. 348, and *Chicago Ry.Terminal Elevator Co. v. IRC* (1986) 75 L.T. 157 and *Brown v. IRC* (1900) 84 L.T. 71; but compare *Akierhelm v. De Mare* [1959] A.C. 789 (PC), and *Broken Hill Proprietary Co. Ltd v. Bell Resources Ltd* (1984) 8 A.C.L.R. 609.
[90] Financial Services and Markets Act 2000, s.85(1).

exemptions from this code are considered below. It is important to note that an offer which is not made to the public or which does not involve a request for admission of securities to trading on a regulated market will not fall within these regulations.

THE EXTENT OF THE REQUIREMENT FOR A PROSPECTUS

Offers of transferable securities require the publication of an approved prospectus: s.85(1) FSMA 2000

The first head of liability under s.85 FSMA 2000

It is a criminal offence to fail to have a prospectus approved and to publish it in the following circumstances set out by s.85 of FSMA 2000. The first offence deals with the making of offers to the public without a prospectus relating to that offer having been approved first, under s.85(1) of FSMA 2000:

> 'It is unlawful for transferable securities to which this subsection applies to be offered to the public in the United Kingdom unless an approved prospectus has been made available to the public before the offer is made.'

Thus, a prospectus must be approved and "made available" to the public before transferable securities are offered to that public. The term "transferable securities" in this context[92] "means anything which is a transferable security for the purposes of the investment services directive[93], other than money-market instruments for the purposes of that directive which have a maturity of less than 12 months".[94] However, Sch.11A FSMA 2000 provides for a variety of categories of exempt instruments which would otherwise be transferable securities but which are excluded from the ambit of "transferable securities" for the purposes of s.85(1) FSMA 2000, as considered below.

Requests for admission to trading on a regulated market require a prospectus

Section 85(2) of FSMA 2000 sets out a second criminal offence, which may also give rise to a civil liability to compensate for loss, in the following terms:

> 'It is unlawful to request the admission of transferable securities to which this subsection applies to trading on a regulated market situated or operating in the United Kingdom unless an approved prospectus has been made available to the public before the request is made.'

This second offence, then, relates to the admission to listing on any regulated market, not necessarily the official list and not necessarily in conjunction with an offer as considered in s.85(1). The term "transferable securities" in this context refers to all

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[91] Financial Services and Markets Act 2000, s.85(2).
[92] Financial Services and Markets Act 2000, s.102A(1), referring to all provisions in Part VI of that Act.
[93] This directive is due to be replaced by the Markets in Financial Instruments Directive ("MiFID") in the UK with effect from 1st November 2007.
[94] Financial Services and Markets Act 2000, s.102A(3).

transferable securities except for units in an open-ended investment scheme, non-equity transferable securities issued by a public body in an EEA state, shares in the capital bank of an EEA state, securities guaranteed by a public body in an EEA state, non-equity transferable securities issued in a repeated manner by a credit institution[95], and non-fungible shares of capital intended to provide a right in immoveable property which cannot be sold without giving up that right.[96] Notably, it is not a requirement that securities have already been admitted to trading on that regulated market: rather, it is sufficient that a request for their admission has been made.

Private law liability further to s.85 FSMA 2000

Breach of the duties implied by s.85 of FSMA 2000 (as considered above) create an action to recover compensation for loss suffered as a result of a breach of s.85. The nature of the private law liability which might arise further to s.85 FSMA 2000 is expressed in s.85(4) FSMA 2000 in the following terms:

> 'A contravention of subsection (1) or (2) is actionable, at the suit of a person who suffers loss as a result of the contravention, subject to the defences and other incidents applying to actions for breach of statutory duty.'

A person who commits a breach of statutory duty which causes another person loss will be liable in tort for damages.[97] The tort of "breach of statutory duty simpliciter"[98] will render the defendant liable for damages.[99] The source of the claim is the loss suffered "as a result of" the contravention of s.85: that is, a loss which is caused by the breach of s.85.

Exemptions and exclusions from the prospectus regulations

Matters excluded from being offers of transferable securities under s.85 FSMA 2000

Schedule 11A to the FSMA 2000 provides for three categories of securities which are excluded from the ambit of the term "transferable securities" for the purposes of the offence committed under s.85(1) of FSMA 2000. The first category relates primarily to government and similar securities.[100] The second category relates to securities in not-

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[95] Which are not subordinate, convertible or exchangeable.
[96] Financial Services and Markets Act 2000, Sch. 11A.
[97] *Groves v Lord Wimborne* [1898] 2 QB 402; *X (minors) v Bedfordshire County Council* [1995] 2 A.C. 633; *O'Rourke v Camden LBC* [1998].
[98] *X (minors) v Bedfordshire County Council* [1995] 2 A.C. 633. See generally *Clerk & Lindsell on Torts*, Sweet & Maxwell, 19th ed., 2006, para 9-06 *et seq*.
[99] *Cutler v Wandsworth Stadium Ltd* [1949] A.C. 398.
[100] Financial Services and Markets Act 2000, s.85(5)(a), as supplied by Financial Services and Markets Act 2000, Sch.11A. Thus, the term "transferable securities" in the context of the prospectus rules does not refer to: units in a collective investment scheme; non-equity, transferable securities issued by the government or local authorities in an EEA State, or by the European Central Bank, or the central bank of an EEA State; shares in the share capital of the central bank of an EEA State; transferable securities which are irrevocably and unconditionally guaranteed by the government or a local or regional authority of an EEA State. Also excluded from the definition of "transferable securities" in this context are non-equity transferable securities which are "issued in a continuous or repeated manner by a credit institution" on the condition that

for-profit organisations.[101] The third category then divides between two further types of security which do not constitute "transferable securities" for the purposes of the prospectus rules.[102]

Exemptions from the requirement for a prospectus

The exemptions from liability for failure to make available an approved prospectus in relation to the offences in section 85 are provided in section 86 of FSMA 2000.[103] There is no contravention of s.85 in any of these circumstances. The first exemption relates[104] to an offer which is only made to or directed at people (whether financial institutions, public bodies or recognised individuals) who are registered by the FSA as being "qualified investors". The second exemption relates to offers made to fewer than one hundred people, because such a small group would not be "the public".[105] The third exemption relates to large issues beyond the reach of ordinary, retail investors in which the minimum consideration is at least 50,000 euros. The fourth exemption relates to large denomination issues where the securities being offered are denominated in amounts of at least 50,000 euros. The fifth exemption relates to small issues where the total consideration for the transferable securities being offered cannot exceed 100,000 euros. The sixth possible exemption relates to situations in which a non-qualified investor engages a qualified investor to act as his agent and where that agent has discretion as to his investment decisions,[106] because the expertise of the qualified investor will shield the issuer from liability to comply with the prospectus requirement in s.85 of FSMA 2000.

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they are not subordinated, convertible or exchangeable, that they do not give a right to subscribe to or acquire other types of securities and are not linked to a derivative instrument; that they "materialise reception of repayable deposits"; and that they are covered by a deposit guarantee under the EC deposit guarantee directive. The final exclusion in the first Part of Sch.11A relates to non-fungible shares of capital intended to provide a right in immoveable property which cannot be sold without giving up that right.

[101] The Charities Act 2006 has extended the range of charitable purposes under English law: see Alastair Hudson, *Equity & Trusts,* (Routledge-Cavendish, 2009), Chapter 25, "Charities". Part 2 of Schedule 11A then contains a further set of entities which may issue securities without falling within the prospectus rules. Broadly-speaking, these entities are not-for-profit entities which would not have shareholders with the result that the underlying policy concerns of the prospectus rules as to investor protection would not ordinary apply to these entities. Consequently, the term "transferable securities" within the prospectus rules does not apply to securities issued by a charity, a housing association, an industrial and provident society, or a "non-profit making association or body" recognised by an EEA State.

[102] Financial Services and Markets Act 2000, Sch.11A, para 8. First, non-equity transferable securities which are "issued in a continuous or repeated manner by a credit institution" if the total consideration for the offer is less than 50 million euros and they are not subordinated, convertible or exchangeable, that they do not give a right to subscribe for nor to acquire other types of securities and are not linked to a derivative instrument; that they "materialise reception of repayable deposits"; and that they are covered by a deposit guarantee under the EC deposit guarantee directive. Secondly, an offer where the total consideration for the offer is less than 2.5 million euros.

[103] These provisions are expanded on in broadly similar terms in Prospectus Rules, para 1.2.2R "exempt securities – offers of securities to the public" and Prospectus Rules, para 1.2.3R "exempt securities – admission to trading on a regulated market".

[104] Financial Services and Markets Act 2000, s.86(1).

[105] Financial Services and Markets Act 2000, s.86(3).

[106] Financial Services and Markets Act 2000, s.86(2).

Further exempt categories under the Prospectus Rules

The FSA is given a power, further to s.85(5)(b) of FSMA 2000, to create regulations under the Prospectus Rules to exempt further categories of offers of securities. In relation to offers of securities to the public, they include shares issued in substitution for shares of the same class;[107] transferable securities offered in connection with a takeover[108] or with a merger[109]; shares which are to be offered or allotted free of charge to existing shareholders and dividends which are to be paid in the form of shares[110]; or transferable securities offered or allotted to existing or former directors or employees by their employer where those transferable securities have already been admitted to listing.[111] Securities which are to be admitted to trading on a regulated market may be exempt under this head where they are shares representing less than 10 per cent of the shares of the same class already admitted to trading on the same regulated market over a period of twelve months[112]; or securities of the type mentioned above in relation to offers of securities to the public.

Transactions where the issuer elects to have a prospectus

In relation to offers of securities which are exempted from the requirement to have a prospectus, it is possible for an issuer to elect to have a prospectus further to s.87 of FSMA 2000. If a person so elects to have a prospectus then that person is bound by the Prospectus Rules[113] but not by the UKLA Listing Rules[114] (because the Listing Rules would only apply if the securities were to be listed, and if they were to be listed then a prospectus would be required in any event).[115] An issuer might decide that there is a marketing advantage to be had by complying with the Prospectus Rules, such as the promotion of investor confidence in the high quality, transparency and probity of the issuer if that issuer is not well known to the market. The kinds of transferable securities which are most commonly at issue here are[116] non-equity transferable securities issued by a public body in an EEA state, securities guaranteed by a public body in an EEA state, non-equity transferable securities issued in a repeated manner by a credit institution[117], transferable securities included in an offer of less than 2.5 million euros.[118]

[107] Prospectus Rules, para 1.2.2(1)R.
[108] Prospectus Rules, para 1.2.2(2)R.
[109] Prospectus Rules, para 1.2.2(3)R.
[110] Prospectus Rules, para 1.2.2(4)R.
[111] Prospectus Rules, para 1.2.2(5)R.
[112] Prospectus Rules, para 1.2.3(1)R.
[113] Financial Services and Markets Act 2000, s.87(2).
[114] Financial Services and Markets Act 2000, s.87(3).
[115] Listing Rules, para 2.2.10(2)(a)R.
[116] Financial Services and Markets Act 2000, s.87(4).
[117] Which are not subordinate, convertible or exchangeable.
[118] Financial Services and Markets Act 2000, Sch. 11A.

The general duty of disclosure of information in prospectuses

The duty of disclosure in s.87A FSMA 2000

The duty of disclosure is central to the rules on the preparation of prospectuses. There is a general duty of disclosure of information in the sense that there is a duty to make full disclosure of the "necessary information" in a prospectus before that prospectus can be approved for the purposes of s.85 of FSMA 2000 by the FSA as competent authority. Therefore, the general duty of disclosure suggested in this discussion is to be inferred from the fact that without such disclosure the criteria for the FSA to approve the prospectus will not have been satisfied, and so there cannot be an offer of transferable securities to the public[119] nor a request for admission of securities to trading on a regulated market.[120]

This general duty of disclosure is set out in s.87A of FSMA 2000. The effect of this duty of disclosure is that prospectuses must contain all the information which investors would require to make an informed assessment of the securities. The duty of disclosure is rooted in the requirement that the prospectus must contain the "necessary information" before it can be approved by the FSA. Section 87A(1) of FSMA 2000 provides as follows:

> 'The competent authority may not approve a prospectus unless it is satisfied that-
> (a) the United Kingdom is the home State in relation to the issuer of the transferable securities to which it relates,
> (b) the prospectus contains the necessary information, and
> (c) all of the other requirements imposed by or in accordance with this Part or the prospectus directive have been complied with (so far as those requirements apply to a prospectus for the transferable securities in question).'

Therefore it is s.87A(1)(b) which contains the requirement that the "necessary information" be contained in the prospectus. The requirements that the UK is the home state, briefly put, means that the issue must have been presented for authorisation in the UK first.

The definition of "necessary information" is contained in s.87A(2) of FSMA 2000 in the following terms:

> 'The necessary information is the information necessary to enable investors to make an informed assessment of –
>
> > (a) the assets and liabilities, financial position, profits and losses, and prospects of the issuer of the transferable securities and of any guarantor; and
> > (b) the rights attaching to the transferable securities.'

There are therefore four significant elements to this general duty of disclosure, which are considered in the sections to follow.

[119] Financial Services and Markets Act 2000, s.85(1).
[120] Financial Services and Markets Act 2000, s.85(2).

Which prospectuses are covered by this duty

First, the duty applies only to prospectuses which are to be submitted to the competent authority – the FSA – further to s.85 FSMA on the basis that an application is being made for admission to the Official List or for admission to trading on a regulated market, but not otherwise. For other forms of prospectus issued in relation to other forms of security it will be the case law principles which govern liability.

The "informed assessment" criterion

Secondly, the test for what type of information should be contained in the prospectus is an "informed assessment" test. This is not a requirement of "reasonableness", nor is it a test based on the information which a professional advisor would require. That there is no reference to a professional advisor in s.87A FSMA 2000 means that those preparing the prospectus cannot assume the presence of a professional advisor and so cannot assume that they can omit information which a professional advisor is bound to know. Instead, because s.87A(2) refers only to "investors" making an informed assessment it is necessary for the prospectus to contain all of the information which might be required for those investors to make an informed assessment, including information and warnings as to risks and so forth which it would be expected that professional advisors would appreciate. Therefore, the prospectus must couch its information in language which makes those risks evident even to a layman; it must avoid communicating only in jargon which retail investors may not understand, unless those terms are defined or explained. There may also be similar difficulties relating to the use of prospectuses by investors in the after-market. The liability to such people in tort is considered in detail in Chapter 41 of this book.

The keynote of this duty of disclosure in s.87A is the need to ensure the investor can make an "informed assessment". Those preparing the prospectus must consider what level of information is required in writing in the prospectus so that the investor can be sufficiently well informed so as to make an assessment of the investment prospects offered by the securities. This requirement is, however, not concerned with the presentation or discussion of absolutely all of the information which may possibly affect the issuer or its market. A prospectus has never been intended to be a textbook on management theory or economics which eventually hones in on the securities issue in question. Rather, the investor must decide whether or not he wishes to take a risk by investing in this security rather than taking a risk by investing in another security. After all, all investment involves risk.[121] What is required of a prospectus is that it contains all of the information which is necessary to enable the investor to decide in an appropriately informed manner about the securities in question. This question can only really be understood by approaching it from the opposite direction from that which is taken in s.87A(2): the question is how much information must be provided so that the investor knows all that it is necessary to know when deciding whether or not to buy the securities.

Consequently, the issuer and its advisors are involved in an art and not a science in terms of casting the net of information contained in the prospectus as widely as they need to cast it, but also judging at what point the informational coverage can stop. The

[121] *Royal Brunei Airlines v Tan* [1995] 2 A.C. 378, *per* Lord Nicholls.

question then is as to the information which an *informed* investor would *need* to find in a prospectus. This is, it is suggested, different from asking what sort of information a *reasonable* investor would *expect* to find in a prospectus. The statute does not ask us to imagine a reasonable investor. A reasonable investor would not require information of the sort that one may find in "an idiot's guide to investing", relating for example to the effect which macroeconomic data like movements in interest rates or the commencement of an unexpected land war in Europe might have on a company's prospects. So, we might *read in* a standard of reasonableness to the preparation of prospectuses or else the business of producing them would become untenable with the weight of background information which some particularly naïve retail investors may be thought to require. However, it should be noted that such a standard of reasonableness is not contained in s.87A explicitly.

In this regard, s.87A(4) provides that:

> 'The necessary information must be must be prepared having regard to the particular nature of the transferable securities and their issuer.'

This provision tells us that the information must be relative to the nature of the securities in question and to the nature of the issuer. It also requires the prospectus to present information about the securities themselves, as opposed to generic information, and about the issuer particularly such that an unusual issue would require more information, or a little known start-up company issuing securities would require more information, and so forth, than would a well-known company in a well-known market. Well-known companies in well-known markets – such as high street retailers or clearing banks – making issues of plain vanilla securities – such as ordinary shares of the same class as those already in issue – would not require a large amount of specialist information beyond that normally found in prospectuses. Thus, the provision of information can start at a level relative to the issuer's particular market and particular corporate structure and financial condition. However, a technology company developing new products in new markets and which is little known in the markets in which a general offer to the public is being made would require a much larger amount of background information as to the company's organisation, products, markets and so forth to be made available to investors. It is when there are matters which may not be obvious to all investors – as to the issuer's market, or as to the manner in which the issuer's accounts were prepared, or as to the issuer's group structure, and so forth – that the issuer is required to begin to provide information which goes further than might ordinarily be required.

The relevant information to be provided

Thirdly, the relevant information which must be provided is not all information which may possibly relate to the issuer. Rather, the information which is required is that information which enables a reasonable investor to make an informed assessment of four things: the assets and liabilities of the issuer, the financial position of the issuer, the profits and losses of the issuer, and the prospects of the issuer. The prospectus is likely to range across other issues which are likely to be of significance to a reasonable investor and its professional advisors, but the types of information which are identified in s.87A of FSMA 2000 are limited to these four. A discussion of the issuer's prospects, for example, will require a greater range of types of information than simply accounting information. As is considered below, the nature of the information which is required may also be dependent on the likely pool of investors, where more expert investors may require less information (for example) as to the risk profile of ordinary securities than retail investors.

Information as to the rights attaching to the securities

Fourthly, the prospectus must provide information as to the rights which will attach to the securities which are to be issued. In relation to debt securities or convertible securities, this may be more complex than in relation to the voting and other rights attaching to ordinary shares.

The requirement for comprehensible and easily analysable presentation of the necessary information

The manner in which the necessary information is to be set out is described in s.97A(3) of FSMA 2000 in the following way:

> 'The necessary information must be presented in a form which is comprehensible and easy to analyse.'

The obligation to make the information comprehensible and easy to analyse is a result of requiring disclosure of information which will satisfy ordinary investors. The dictionary definition of "comprehensible" is that the matter "may be understood".[122] If something may be understood by someone, then it might be comprehensible even if it cannot be understood by everyone. What is important, it is suggested, in relation to prospectuses is that an ordinary investor would be able to understand what assertion is being made by the statement in the prospectus on a reasonable basis. That is, no ambiguity must be permitted which would conceal the true meaning of a statement in a prospectus which is otherwise encouraging investors to acquire securities; and there must also be sufficient disclosure of the basic information.

The significance of the general duty of disclosure in s.87A FSMA 2000

Section 87A therefore provides an underpinning standard which is to be observed by those creating a prospectus by reference to which any more specific provision can be interpreted and any matter beyond the scope of those detailed rules can be considered. The significance of high-level principles in these contexts is that they both contain flexible rules in themselves – requiring professional advisors to be acclimatised to regulatory practice in relation to different types of securities issues – and also serve as a means of interpreting detailed regulation.

The requirement for a supplementary prospectus: s.87G FSMA 2000

Section 87G FSMA 2000 provides that a supplementary prospectus is required to be published in the following circumstances:[123]

[122] *Shorter Oxford English Dictionary*.
[123] Financial Services and Markets Act 2000, s.87G(2).

> 'if, during the relevant period, there arises or is noted a significant new factor, material mistake or inaccuracy relating to the information included in a prospectus [or in a supplementary prospectus][124] approved by the competent authority.'

Therefore, this obligation arises in relation to prospectuses which have already been approved. If the prospectus had not been approved when such a matter came to the parties' attention then, it is suggested, the obligation under s.87A of FSMA 2000 to provide all necessary information would require that the prospectus was amended and that this information was added to it before approval could take place. The "relevant period" is the time between the regulatory approval of the prospectus and the start of trading in the securities. The requirement of "significance" is defined by s.87G(4) to be something which is significant in relation to the categories of "necessary information" in s.87A(2).

Criteria for the approval of a prospectus by the FSA

The detail of the approval process – primarily a timetable, and a requirement of the consideration of the material discussed above – is not set out here. Those rules are set out in s.87C FSMA 2000 and Chapter 3 of the Prospectus Rules. Approval or disapproval of a prospectus must be given in writing to the issuer.[125] In either event, the notice of the decision must give the FSA's reasons for that decision[126] and inform the applicant of its right of appeal to the Tribunal under FSMA 2000.[127]

The required contents of a prospectus

The central principle as to the contents of a prospectus

The required contents of a prospectus can be best understood as operating on the basis of the general obligation to make disclosure under s.87A of FSMA 2000, as was considered in detail above. Thus, the prospectus must provide all of the "necessary information" to enable an investor to be able to make "an informed assessment" as to those securities. Bearing that underlying principle in mind, we shall now consider some of the key requirements of the Prospectus Rules.

The form of a prospectus

A prospectus may be in the form of a single document or of separate documents.[128] A prospectus in a single document must be divided between a registration document, a securities note and a summary.[129] Section 87A(5) FSMA 2000 provides that a "summary

[124] Financial Services and Markets Act 2000, s.87G(7).
[125] Financial Services and Markets Act 2000, s.87D(1), and (2) and (4) respectively.
[126] Financial Services and Markets Act 2000, s.87D(3).
[127] Financial Services and Markets Act 2000, s.87D(5).
[128] Prospectus Rules, para 2.2.1R; PD art. 5.3.
[129] Prospectus Rules, para 2.2.2(1)R.

must, briefly and in non-technical language, convey the essential characteristics of, and risks associated with, the issuer, any guarantor and the transferable securities to which the prospectus relates."[130] A prospectus in the form of separate documents must have a registration document which contains the information relating to the issuer and a securities note which contains the information about the transferable securities which are to be offered to the public or to admitted to trading.[131]

The manner in which detailed contents of a prospectus are identified in the regulations

The detailed required contents of prospectuses depend on the type of securities which are in issue. The minimum information to be included in a prospectus is considered in articles 3 to 23 of the Commission's Prospectus Directive Regulation.[132] Appendix 3 to the FSA Prospectus Rules then contains a large amount of material divided between schedules of required minimum information, and building blocks containing additional information required for different types of issue. In effect, different forms of security require different forms of information, over-and-above a standard base which is required for all issues. Think of it as a type of regulatory pizza in which there is a standard base (bread and tomato sauce), and then different types of pizza have different toppings on top. That material is far, far too detailed to be included in this reading. However, it can be read on-line if you so choose.

Omission of information in a prospectus

The FSA may authorise omission of information otherwise required to be included in a prospectus further to section 87B FSMA 2000 if its disclosure would be contrary to the public interest; or would be seriously detrimental to the issuer (provided that its omission would be unlikely to mislead the public); or where the information is only of minor importance. Such an authorisation must be made in writing by the applicant.[133]

The general obligation to obey the Prospectus Rules

There is a general obligation imposed on all persons to whom any individual rule is specified as being applicable to obey that rule.[134] Further to s.91(1A) of FSMA 2000, any contravention of the listing rules opens an issuer or any persons offering securities for sale to the public or seeking their admission to a regulated market up to a penalty from the FSA if there has been either a contravention of Part 6 of FSMA 2000 generally, or a contravention of the prospectus rules, or a contravention of the transparency rules. Penalties may also be imposed on directors of the perpetrator if the FSA considers it to be appropriate.[135] In place of financial penalties, the FSA may instead issue a statement of censure.[136]

[130] Financial Services and Markets Act 2000, s.87G(6).
[131] Prospectus Rules, para 2.2.2(2)R.
[132] Prospectus Rules, para 2.3.1.
[133] Prospectus Rules, para 2.5.3R.
[134] Prospectus Rules, para 1.1.3R.
[135] Financial Services and Markets Act 2000, s.91(2).
[136] Financial Services and Markets Act 2000, s.91(3).

The Contexts in which Listing Particulars are Required

Listing particulars were required for the admission of securities to listing generally before the introduction of the Prospectus Regulations on 1 July 2005. Listing particulars are now required only in relation to offers of securities which are being made to a specified category of, effectively, expert investors, further to Chapter 4 of the FSA Listing Rules. Due to their reduced significance they will receive no further specific coverage in this discussion.[137]

[137] See Alastair Hudson, *Securities Law* (Sweet & Maxwell, 2008), Chapter 13 for a detailed account of the applicable statutory rules and regulations.

CHAPTER 5.

CIVIL LIABILITY FOR PREPARATION OF PROSPECTUSES

Introduction

This chapter considers the liabilities which may arise in relation to offers of securities.[138] Offers of securities are offers to enter into a contract. That contract may be entered into between the issuer of securities and a subscriber for those securities, or it may be entered into between an owner of securities and a purchaser in the after market. Typically, in relation to both kinds of securities, it will be issuer of the securities which will have made a number of representations as to the quality and nature of those securities in any prospectus that was published in advance of their issue. If the issuer is a party to the contract, then liability may lie in contract or in tort for fraudulent or negligent misrepresentation. If the issuer is not a party to the contract, then liability may lie in tort for misrepresentation. The people who are liable for the preparation of the prospectus and for other statements about the securities extend beyond the issuer itself into a range of other agents, advisors and experts, as considered below.[139]

Liability of this sort arises under the general law and further to s.90 of FSMA 2000. This chapter begins by considering the general law of misrepresentation as it applies to securities issues before turning to the heads of statutory liability under FSMA 2000 because that is the most convenient way of explaining the issues which have arisen and how developments in securities regulation will effect the older case law principles.

Liability under the general law

The approach of the old cases to issues of securities

The old cases dealing with issues of shares were clear that the people preparing a prospectus must state everything with “strict and scrupulous accuracy”,[140] must include every fact which investors could require to know and must not mask information in ambiguity. The approach to the preparation of prospectuses was set out by Kindersley V-C in *New Brunswick, etc., Co. v. Muggeridge*[141] in the following way:

> ‘Those who issue a prospectus, holding out to the public the great advantages which will accrue to persons who will take shares in a proposed undertaking, and inviting them to take shares on the faith of the representations therein contained, are bound to state everything with strict and scrupulous accuracy, and not only to

[138] This chapter is based on elements of Alastair Hudson, *Securities Law* (1e, Sweet & Maxwell, 2008) which contains a much more detailed discussion of the contents of this chapter in pages 533-741.
[139] See para
[140] *New Brunswick, etc., Co. v. Muggeridge* (1860) 1 Dr. & Sm. 363, 383, *per* Kindersley V-C.
[141] (1860) 1 Dr. & Sm. 363, 383.

abstain from stating as fact that which is not so, but to omit no one fact within their knowledge, the existence of which might in any degree affect the nature, or extent, or quality, of the privileges and advantages which the prospectus holds out as inducements to take shares.'

This approach – that a prospectus must be prepared with "strict and scrupulous accuracy" – in the case law was approved in many subsequent cases. So, in *Central Railway of Venezuela v. Kisch*,[142] Lord Chelmsford said that no misstatement or concealment of any material facts or circumstances ought to be permitted. In his Lordship's opinion the public, who were invited by a prospectus to join in any new venture, ought to be given the same opportunity as the promoters themselves to judge everything which had a material bearing on the true character of the company's proposed undertakings. Consequently, it was held that the utmost candour ought to characterise the promoters' public statements.

It is interesting to note that the FSA Prospectus Rules take a broadly similar approach to the obligations of those preparing the prospectus to include all necessary information. It is mandatory to produce a prospectus when making an offer of securities to the public or when seeking admission of securities to listing on a regulated market, in that it is an offence not to made such a prospectus available beforehand.[143] The Listing Principles contained in chapter 7 of the listing rules require that those preparing prospectuses to act with "integrity" not only in the preparation of prescribed documentation but also in all of their dealings with the Financial Services Authority. Those preparing the prospectus must ensure that it contains all "necessary information" for an investor to make an informed decision when investing in securities.[144] A listed company is also required to have adequate procedures to identify any further information which should be made available to the investing public through a recognised information service.[145] Consequently, securities regulation now impose positive, continuing obligations on companies as to the full disclosure of relevant information and are not limited to "strict and scrupulous accuracy" in the preparation of the initial prospectus.

Liability for a false prospectus at common law

Liability for a false prospectus at common law will arise in a number of different contexts, as considered in this chapter. The first question is whether or not the persons responsible for the contents of the prospectus acted fraudulently. If so, liability for damages for fraudulent misrepresentation in contract law may arise. Alternatively, liability may lie for damages in tort for deceit. If dishonesty was involved, then criminal liability may lie for theft or for fraud. If there was no fraud, then liability may lie for damages in contract for negligent misrepresentation: primarily under the doctrine set out in the leading case of *Caparo v Dickman* and the head of liability established in *Hedley Byrne v Heller*. This discussion will focus on negligence – the other areas (if you are interested) are considered in gratuitous detail in Alastair Hudson, *Securities Law*.

[142] (1867) L.R. 5 H.L. 99, 123.
[143] Financial Services and Markets Act 2000, s.85.
[144] Financial Services and Markets Act 2000, s.87A.
[145] Listing Rules, chapter 7, section 7.2.

The central principle of the tort of negligence

The principle in Caparo v Dickman

In order to recover damages based on the tort of negligent misrepresentation, the plaintiff must establish that the defendant owed him a duty of care not to cause loss or damage of the kind caused by breach of that duty. The leading decision is that of the House of Lords in *Caparo Industries plc v Dickman*.[146] The principal liability in this context is related to the making of a negligent misstatement in a prospectus on which a purchaser of securities relies and so suffers loss. The principle underpinning liability in tort for negligent misrepresentation is contained in the decision in *Hedley Byrne v Heller*.[147] That principle was summarised for the purposes of negligent misrepresentations made in prospectuses by Lightman J in *Possfund v Diamond*[148] in the following terms:

> 'In 1963 the House of Lords in *Hedley Byrne v Heller & Partners Ltd*[149] established that at common law a cause of action exists enabling the recovery of damages in respect of a negligent misrepresentation occasioning damage and loss where the necessary proximity exists between the representor and representee. It is clearly established (and indeed common ground on these applications) that in a case such as the present, where the defendants have put a document into more or less general circulation and there is no special relationship between alleged between the plaintiffs and the defendants, foreseeability by the defendants that the plaintiffs would rely on the prospectus for the purposes of deciding whether to make after-market purchases is not sufficient to impose upon the defendant a duty of care in such a situation requires a closer relationship between representor and representee, and its imposition must be fair, just and reasonable.'

There are three criteria for the imposition of a duty of care in any given situation: foreseeability of damage, proximity of relationship and reasonableness.[150]

The position was expressed in the following terms by Lord Oliver in *Caparo Industries plc v. Dickman*:[151]

> 'What can be deduced from the *Hedley Byrne*[152] case, therefore, is that the necessary relationship between the maker of a statement or giver of advice (the adviser) and the recipient who acts in reliance on it (the advisee) may typically be held to exist where (1) the advice is required for a purpose, whether particularly specified or generally described, which is made known, either actually or inferentially, to the adviser at the time when the advice is given, (2) the adviser

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[146] [1990] 2 A.C. 605.
[147] [1963] 2 All E.R. 575, [1964] A.C. 465.
[148] *Possfund Custodian Trustee Ltd v Diamond* [1996] 2 All E.R. 774, [1996] 1 W.L.R. 1351, [1996] 2 B.C.L.C. 665, *per* Lightman J.
[149] [1963] 2 All E.R. 575, [1964] A.C. 465.
[150] See *Smith v. Bush* [1990] 1 A.C. 861 (H.L.) at 865 per Lord Griffiths, and also *Caparo Industries plc v. Dickman* [1990] 2 A.C. 605.
[151] [1990] 2 A.C. 605.
[152] [1964] A.C. 465.

knows, either actually or inferentially, that his advice will be communicated to the advisee, either specifically or as a member of an ascertainable class, in order that it should be used by the advisee for that purpose, (3) it is known, either actually or inferentially, that the advice so communicated is likely to be acted upon by the advisee for that purpose without independent inquiry and (4) it is so acted on by the advisee to his detriment. That is not, of course, to suggest that these conditions are either conclusive or exclusive, but merely that the actual decision in the case does not warrant any broader propositions."[153]

What this formulation does not take into account is a regulatory requirement under the Prospectus Rules that the statement is question was included in the prospectus and that there would be continuing obligations under those same regulations to ensure the continued accuracy of that statement. In such a circumstance, it is suggested, that the issuer must have known that the statement would be relied upon by investors in the after-market as well as initial subscribers for the securities. The principles established in the cases considered in this section were decided before the modern regulatory environment emerged, but should nevertheless now be read in that light.

Liability for negligent misrepresentations in accounts prior to a takeover: Caparo Industries v Dickman

The *Caparo Industries plc v Dickman* appeal related to a claim brought by a claimant which had acquired shares in a target company, Fidelity plc, as part of a takeover. The claimant contended that it had relied on Fidelity's accounts for the accounting year 1983-84, which had been audited by the accountants Touche Ross and which showed a pre-tax profit of £1.3 million. After acquiring a controlling shareholding in the target company, the claimant discovered that the company's financial position ought to have demonstrated a loss of £0.4 million. Consequently, the claimant sought to establish a breach of a duty of care in negligence on the part of the accountants when acting as the auditors of the company. The claimant argued that, as a person intending to acquire a controlling shareholding in the company, the accountants owed it a duty of care when auditing the company's accounts. Lord Bridge held that

> "If a duty of care were owed so widely, it is difficult to see any reason why it should not equally extend to all who rely on the accounts in relating to other dealings with a company as lenders or merchants extending credit to the company".[154]

Therefore, it was held that on policy grounds a general duty of care ought not to be imposed on auditors in such situations.[155]

The claim brought in *Caparo v Dickman* asserted a very wide duty of care in relation to those contemplating takeover the of companies. An assertion which was considered by the House of Lords simply to extend too far. What emerges from Lord Bridge's speech, however, is a range of issues beyond this narrow focus on the context of takeovers and

[153] [1991] 2 A.C. 605 at 638. See also Lord Bridge at 620-621 and Lord Jauncey at 659-660 (esp. at 660E "the fundamental question of the purpose").
[154] [1990] 2 A.C. 605.
[155] Approving *Al Saudi Banque v Clark Pixley* [1990] Ch 313.

the wider policy considerations. Lord Bridge also held that the salient feature of cases following *Hedley Byrne v Heller*,[156] relating to the liability of those making misstatements in tort to those relying on those statements and suffering loss as a result, was that the defendant "knew" either that the advice or statement made would be communicated to the claimant directly or indirectly, and further that the defendant "knew" that the claimant was very likely to rely on that advice or statement. Significantly, then, the *Hedley Byrne* line of cases had referred to situations in which the claimant was a person within the contemplation of the person responsible for the statement.

The effect of the change in principle in Caparo Industries v Dickman

In applying the principle in *Anns v Merton LBC (*which pre-dated *Caparo v Dickman*), Woolf J held at first instance in *JEB Fasteners Ltd v. Marks, Bloom & Co*[157] that where accounts had been prepared in a situation in which a takeover of the company was a possible and foreseeable means of obtaining finance, then the accountants owed a duty of care to the claimant who subsequently did take the company over and suffer loss as a result of having relied, *inter alia*, on misstatements in those accounts. As a result of the decision in *Caparo Industries plc v Dickman*, such an approach became untenable. So in *McNaughton Papers Group v Hicks Anderson*,[158] accounts were prepared specifically for the target company, MK, and therefore were not considered to be statements on which the claimant (who was seeking to take over MK) could rely as having created a duty of care once the claimant had taken over the target company in reliance on misstatements made in those accounts. The rationale for this decision was that the purpose for which the statements were made (here, as part of accounts prepared for the benefit of MK alone) precluded any other person from relying on them to found a duty of care.

In slightly different circumstances in *Morgan Crucible Co plc v Hill Samuel Bank Ltd*,[159] the directors and financial advisors of the target company had made express representations in the course of a contested takeover forecasting a 38% increase in pre-tax profits at a time when an identified bidder for the company had emerged. The purpose behind these and other representations had been to induce the bidder to make a higher bid. The bidder relied on those statements. The Court of Appeal held that there was therefore a relationship of sufficient proximity between the bidder and those who had been responsible for the statements to found a duty of care in negligence. The decision in *Caparo Industries plc v. Dickman* was distinguished on these facts on the basis that in *Caparo* no identified bidder had emerged at the time when the statements had been made, whereas in *Morgan Crucible Co plc v Hill Samuel Bank Ltd* an identified bidder had emerged and the statements had been made to induce a reaction from that particular bidder.

As outlined immediately above, in *James McNaughton Papers Group Ltd v. Hicks Anderson & Co. (a firm)*[160] it was held that accountants acting for a target company in takeover negotiations owed no duty of care to the bidder in respect of alleged inaccuracies in draft accounts provided to target company for use in the negotiations.

[156] [1964] A.C. 465.
[157] [1981] 3 All E.R. 289.
[158] [1991] 1 All E.R. 134.
[159] [1991] 1 All E.R. 148.
[160] [1991] 1 All E.R. 135.

Neill L.J., delivering the judgment of the Court of Appeal, identified six matters which were likely to be of importance in reaching a decision as to whether or not a duty exists: first, the purpose for which the statement was made; secondly, the purpose for which the statement was communicated; thirdly, the relationship between the adviser, the advisee and any relevant third party; fourthly, the size of any class to which the advisee belongs; fifthly, the state of knowledge of the adviser; and, sixthly, the nature, reasonableness and extent of the reliance of the advisee.[161]

The application of the Caparo doctrine to prospectuses put into wide circulation

It is important, for present purposes, to consider how the *Caparo* principle – relating on its facts specifically to takeover cases – would apply in situations in which the statements made in prospectuses are likely to be put into wide circulation either among a class of investors or made available to the public generally. Beyond the narrow context of takeovers, there is a problem with applying the logic of the preceding cases to cases involving the acquisition of shares on a regulated market in ordinary circumstances precisely because the preparation and publication of a prospectus is obligatory in the context of public offers of securities or the context of the admission of securities to trading on a regulated market is intended to be a statement made to the investing public on which that public can rely when acquiring securities.[162] Therefore, in the context of prospectuses prepared under the prospectus rules it is not a question of a private document being prepared necessarily for the benefit of a limited class of people but rather it is a public document required by statute to be prepared for the benefit of the public at large and concomitantly for the proper regulation of the securities markets.

In this context, Lord Bridge held that:

> 'The situation is entirely different where a statement is put into more or less general circulation and may foreseeably be relied on by strangers to the maker of the statement for any one of a variety of different purposes which the maker of the statement has no specific reason to anticipate.'[163]

Therefore, his lordship's view was that statements put into general circulation would be less likely to attract liability in tort because the maker of that statement could not ordinarily know the purposes to which his statement would be put to use by the claimant. On the facts of *Caparo Industries plc v Dickman* itself, then, an auditor's role is primarily to verify for the benefit of shareholders that the accounts constitute a true and fair view of the financial position of the company and an auditor cannot also be said to be liable for the reliance which a person, even if a current shareholder, might choose to place on that auditor's report in deciding whether or not to acquire a controlling stake in the company.

The distinction between these cases reflects the debate which arises in relation to liability for misstatements in prospectuses. On the one hand those responsible for the prospectus may seek to restrict their liability for statements made in the prospectus by

[161] But *cf: Morgan Crucible Co. plc v. Hill Samuel Bank Ltd* [1991] 1 All E.R. 148.
[162] Financial Services and Markets Act 2000, s.85. See para …
[163] [1990] 2 A.C. 605, [1990] 1 All E.R. 568, 576. Approving *Scott Group v Macfarlane* [1978] 1 N.Z.L.R. 553, 566, *per* Richmond P.

means of contractual exclusion clauses or by providing that their statements are intended only for a limited audience, whereas on the other hand it could be said that the public at large could be expected to have sight of those statements and therefore expect that they ought properly to be able to hold their authors to account in the event that they are proved to have been made negligently. This latter argument has particular force when the offer is an offer of securities to the public.

Two points arise. First, it could be said that such statements made in prospectuses governed by the prospectus rules are known by the persons responsible for preparing them to be statements which are to be relied upon by investors generally and therefore that it does no violence to Lord Bridge's dicta in *Caparo Industries plc v. Dickman*, quoted above, to suggest that the entire investing public is within the contemplation of the person responsible for the contents of the prospectus. Indeed, the purpose of the listing rules could be said, in part, to be to bring the general public within the contemplation of those preparing prospectuses in relation to shares to be offered for sale to that public. Secondly, and following on from that first point, it may be that if an offer of securities were to be made to a restricted class of investors, then it would be in line with the *Caparo* principle to find that the general investing public were not within the contemplation of the person responsible for the contents of the prospectus. As a result, people not within the contemplation of any person responsible for the prospectus ought not to be able to bring a claim in tort in the event that they rely on the prospectus otherwise than as a member of the identified class when acquiring those securities subsequently. However, this latter context pre-supposes, it is suggested, that the offer of securities involved is outwith the prospectus rules and the listing rules because otherwise minimum contents are required in a prospectus (as considered in Chapter 40 of this book) and that prospectus is required to be made available to the public further to s.85 of FSMA 2000.

Whether the duty of care extends to purchasers not within the contemplation of the issuer

<u>The issue</u>

The most difficult question to have arisen on the cases dealing with negligent misrepresentations in prospectuses is the following. Suppose an issuer is seeking to issue securities to a narrow range of investors only, for example by means of a placement where shares are intended only for a limited number of potential investors. The prospectus may be prepared with those intended placees in mind only. However, those securities will latterly be traded in the after-market: that is, they will be sold to people subsequently who were not among the placees. Therefore, the question arises whether or not those people responsible for the prospectus owe a duty of care to the purchasers in the after-market or whether they only owe a duty of care to the placees. The people responsible for the prospectus would like to limit their liability to placees only and would protest that it was only the placees who would be in their contemplation when preparing the prospectus. However, in the context of modern securities regulation which requires the publication of a prospectus which complies with the prospectus rules and the general duty of disclosure in s.87A of FSMA 2000, the alternative approach is that issuers of securities which are to be offered to the public or which are to be admitted to trading on a regulated market (even if not offered to the public) will necessarily be communicating to the general investor community by virtue of publishing that prospectus and maintaining the currency of its contents. The narrow approach has the support of *Al-Nakib Investments (Jersey) Ltd v. Longcroft*;[164] whereas the alternative approach has the support of Lightman J in *Possfund v Diamond*:[165] both cases are considered in turn below.

The narrow conception of the obligation: *Al-Nakib Investments (Jersey) Ltd v. Longcroft*

In *Al-Nakib Investments (Jersey) Ltd v. Longcroft*,[166] C plc incorporated a subsidiary, M Ltd, for the purpose of developing a product. It resolved to float M Ltd on the now-disbanded Unlisted Securities Market[167] and issued a prospectus inviting the shareholders of C plc to subscribe for shares in both C plc and M Ltd by way of a rights issue. The plaintiff subscribed for shares in M Ltd and some months later made purchases of shares in C plc and in M Ltd through purchases on the open market. The plaintiff sued C plc and its directors alleging that the prospectus and two interim reports issued by M Ltd contained misrepresentations as to the identity of the person who would be manufacturing the company's products. Moreover, they argued that the defendants owed the plaintiff a duty of care in issuing the prospectus and interim reports based on the reasonable foreseeability of loss being consequent on the plaintiff's acquisition of those shares. The defendants successfully applied to have the allegations struck out, in so far as they related to the purchases in the after-market, on the basis that they disclosed no reasonable cause of action. As to the prospectus, it was held by Mervyn Davies J that it had been issued for a particular purpose, namely to encourage subscription for shares by a limited class of subscribers and that any duty of care in relation to its issue was directed to that specific purpose only. It had not been directed at purchases in the after-market and therefore any misrepresentation therein could not found a claim based on the tort of negligence.[168]

In this regard, Mervyn Davies J relied, *inter alia*, on dicta of Lord Jauncey in *Caparo Industries plc v Dickman*[169] to the effect that reliance might not be placed on the accounts by the claimant in that case if they had been prepared for certain, limited purposes.[170] Mervyn Davies J sought to rely on that point to the effect that a prospectus prepared for limited purposes ought similarly to be incapable of founding a general liability in tort to any member outwith the contemplated class of readers who may rely on it. Furthermore, and perhaps crucially in the modern context, his lordship found that the fact that these shares were to be listed on the USM, and thus subsequently to be made available for sale to the public, did not in itself create any duty of care in favour of those who did subsequently buy those securities in the after-market.

[164] [1990] 3 All E.R. 321.
[165] *Possfund Custodian Trustee Ltd v Diamond* [1996] 2 All E.R. 774, [1996] 1 W.L.R. 1351.
[166] *Al-Nakib Investments (Jersey) Ltd v. Longcroft* [1990] 3 All E.R. 321.
[167] The forerunner of the present Alternative Investment Market (AIM).
[168] Reliance was placed on *Peek v. Gurney* (1873) L.R. 6 H.L. 377 in which similar conclusion was reached.
[169] [1990] 2 A.C. 605, [1990] 1 All E.R. 568, 607.
[170] His lordship also placed reliance on dicta of Lord Griffiths in *Smith v. Eric S. Bush* [1989] 2 All E.R. 514, 536, to similar effect.

The broader conception of the principle: *Possfund Custodian Trustee Ltd v Diamond*

By contrast in *Possfund Custodian Trustee Ltd v Diamond*[171] there had been a placement of shares on the Unlisted Securities Market and subsequent purchases of those shares after the placement in the after-market. The prospectus prepared in relation to the initial placement greatly understated the issuer's liabilities, being a company specialising in insuring second hand vehicles, to pay extra premiums to syndicates at Lloyds. The company subsequently went into receivership due, in no small measure, to the burden of paying those extra premiums. Purchasers of those shares in the after-market contended that they had relied on those statements made in the prospectus, that it had been reasonable for them to rely on the prospectus in that way in making their purchases, and that those responsible for the prospectus had breached a duty of care owed to purchasers of the shares. In *Possfund Custodian Trustee Ltd v Diamond*[172] claims were brought in the tort of deceit and in the tort of negligent misrepresentation. Lightman J held that, historically both at common law and in statute, the purpose of a prospectus had been:[173]

> "… to provide the necessary information to enable an investor to make an informed decision whether to accept the offer thereby made to take share on the proposed allotment, but not a decision whether to make after-market purchases."

The statutory attitude had not appeared to have changed. The question before the court was, therefore, whether changed market conditions – in which it was alleged that prospectuses were now commonly relied upon by the investor public in the after-market – could justify a change in the attitude of the common law such that the prospectus could be recognised to have an effect on decisions whether or not to make purchases in the after-market.

The principal issue was then one of the proximity of the investor public to the maker of the statement in the prospectus. It was held that where the maker of the statement intends that the prospectus will be relied upon by the public in making investment decisions, then it is reasonable to assume that there is sufficient proximity between those parties. Developing that point more precisely, Lightman J went on to find that even if intention is not in itself a factor sufficient to generate the necessary proximity to found a claim in negligence, it must nevertheless be an important factor in establishing that necessary proximity.[174] As a result Lightman J was prepared to find that where a prospectus is prepared with the intention of inducing the investor public to acquire securities, then a duty of care does arise between those responsible for the contents of the prospectus and that investing public. This issue is considered in greater detail in relation to the section on "proximity" below.

It is suggested that this approach accords with the principles underpinning the Financial Services and Markets Act 2000 and the listing rules that where offers of securities are made to the public, then those obligations identified by the FSA Prospectus Rules as being responsible for the contents of the prospectus ought to be held liable at common law to account to any investor for any loss suffered as a result of some statement in or

[171] [1996] 2 All E.R. 774.
[172] [1996] 2 All E.R. 774, [1996] 1 W.L.R. 1351, [1996] 2 B.C.L.C. 665.
[173] [1996] 2 All E.R. 774, 787.
[174] Relying on *Morgan Crucible Co plc v Hill Samuel Bank Ltd* [1991] All E.R. 148, 160, *per* Slade LJ.

omission from that prospectus. The argument made in *Possfund v Diamond* was that market practice relating to the publication of prospectuses constituted a different context from *Peek v Gurney*, decided in 1873.[175] It was held in *Possfund v Diamond* – before the stringency of the current FSA Prospectus Rules was introduced – that the public availability of the prospectus meant that those responsible for the prospectus must necessarily have had any investor who would refer to that information within their contemplation, even when preparing a prospectus merely for a placement.[176] Lightman J held that "it does seem to me to be at least arguable that a duty of care is assumed and owed to those investors who (as intended) rely on the contents of the prospectus in making such purchases".[177] The decision in *Possfund Custodian Trustee Ltd v Diamond* is a recognition that prospectuses are intended to be relied upon by the public at large and that there was "nothing in the authorities or textbooks which precludes the finding of such a duty".[178] Therefore, while the cases might seem to be capable of a slightly uneasy reconciliation - on the basis that *Al-Nakib* was a placement to limited places, whereas *Possfund* was a more general offer – in truth a reconciliation of these cases is not possible. Lightman J expressed his view in *Possfund* that the decision in *Al-Nakib Investments (Jersey) Ltd v. Longcroft* was one which ought to be overturned by a higher court.[179] His Lordship's intention was clearly for the common law to strike out in a new direction.

Reliance on the misrepresentation

It must be shown that the people making the misrepresentation intended that the claimant relied on the representation, and also that there was sufficient proximity between the statement made and the loss that resulted.[180] When establishing an intention, that intention must be objectively established.[181] It is suggested that if the information was information of a sort which was expected to be provided further to the prospectus rules or the duty of disclosure in s.87A of FSMA 2000, then it would be reasonable for an inexpert investor to rely on that information precisely because its provision was required by the prospectus rules because it was the sort of information which an issuer must supply and on which an investor can therefore reasonably rely.

No fiduciary duty

Australian authority has suggested that there will not be a *fiduciary* duty to ensure, in issuing new shares to the shareholders of another company as part of a takeover, that a proper valuation of the target company's shares is reflected in circulars sent to shareholders.[182]

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[175] (1873) LR 6 HL 377, [1861-73] All ER Rep 116.
[176] *Possfund Custodian Trustee Ltd v Diamond* [1996] 2 All E.R. 774, [1996] 1 W.L.R. 1351, [1996] 2 B.C.L.C. 665, *per* Lightman J.
[177] *Ibid*.
[178] [1996] 2 All E.R. 774, 788.
[179] [1996] 2 All E.R. 774, 789.
[180] *Possfund Custodian Trustee Ltd v Diamond* [1996] 2 All E.R. 774, [1996] 1 W.L.R. 1351, [1996] 2 B.C.L.C. 665, *per* Lightman J.
[181] *Ibid*.
[182] *Pilmer v Duke Group Ltd (in liquidation)* [2001] 2 B.C.L.C. 773.

Examples of misrepresentations in the old case law

When giving judgment in *Henderson v. Lacon*[183] Page-Wood V-C described the principles in these cases as being a "golden legacy". These cases, taken together, have defined the perimeter of situations in which misstatements in prospectuses will and will not attract private law liability. What is particularly significant is the treatment of ambiguous and half-true statements which were intended to entice investors while seeking to avoid making any literally untrue statements. The approach of the courts has been to establish an approach in the old cases which would not permit any statement which effectively sought to create a false market in the securities by seeking to give an incorrect impression of the investment opportunity when considered as a whole.

Whether or not statements create a misleading impression

A statement included in a prospectus will be deemed to be untrue if it is misleading in the form it is made and in context in which it is included.[184] So, one cannot escape liability by making statements which appear to be literally true but which give a misleading impression of the facts. It has been said[185] that "[i]t is not that the omission of material facts is an independent ground for rescission, but the omission must be of such a nature as to make the statement actually made misleading".[186] Grandiloquent statements which are substantially true are not misrepresentations.[187] So, saying that "we believe this company offers a great hope for the future of this country" is a grandiloquent statement which will not be a misrepresentation; whereas, saying "this company will be the most successful business the world has ever seen" would be misleading if the people making that statement knew that the company was unable to meet its debts and was therefore insolvent. The question is whether or not the statement is misleading.

Clearly, statement in financial accounts which misstate the condition of the company will be misleading statements. On the decided cases, making an incorrect statement that more than one-half of the first issue of shares had already been subscribed for[188] will be a misleading statements; that the surplus assets as shown in the last balance sheet amounted to upwards of £10,000 when they did not was a misleading statement.[189] These matters were clearly significant in relation to the financial standing of the company and would have encouraged potential investors to believe that the business was sound, when the true position was different. Statements as to the company's assets or the condition of its accounts would be material representations.[190]

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[183] (1867) L.R. 5 Eq. 249, 262.
[184] *R. v. Kyslant* [1932] 1 K.B. 442.
[185] *McKeown v Boudard Peveril Gear Co. Ltd* (1896) 74 L.T. 712, 713, *per* Rigby L.J..
[186] *Coles v White City (Manchester) Greyhound Assn. Ltd* (1929) 48 T.L.R. 230, CA.
[187] *City of Edinburgh Brewery Co. v. Gibson's Trustees* 1869 7 M. 886.
[188] *Ross Estates Investment Co.* (1868) L.R. 3 Ch. 682; *Kent v. Freehold Land Co.* (1868) L.R. 3 Ch. 493; *Henderson v. Lacon* (1867) L.R. 5 Eq. 249. As to the meaning of "subscribed", see below.
[189] *Re London and Staffordshire Fire Insurance Co.* (1883) 24 Ch. D. 149.
[190] *Ibid*.

Misleading statements have been held to actionable misrepresentations on the following bases: that a particular mine was in full operation and making large daily returns[191]; that patented articles were a commercial success and beyond the experimental stage[192]; that the company was the sole manufacturer of asbestos in France and had a practical monopoly;[193] that the company's process was a commercial success;[194] and that the vendors in nitrate grounds had obtained a supply of water brought to them in pipes such that the company would have the right of using a certain part of the water.[195] All of these statements were incorrect and therefore constituted misleading statements in their respective documentation. A statement that something will be done in the future is not a statement of an existing fact so much as a contract or promise. It may, however, imply the existence of facts which are non-existent, or it may be a material term in the contract,[196] and a representation of belief, expectation or intention may be a representation of fact, for "the state of a man's mind is as much a matter of fact as the state of his digestion".[197]

Statements about new businesses

When dealing with start-up companies before their incorporation, it is common for enthusiastic statements to be made to encourage investors to participate in the new business. In relation to start-up companies, the statements made in the prospectus as to the condition and financial position of the company will be more important than otherwise because there is no trading record on which investors can rely. Therefore, it is suggested, it will be easier for investors to demonstrate that they were acting in reliance on such statements. Where a company was formed to buy a mine, and extracts from the report of an expert were set out which gave a misleading impression of that report and induced the belief that the mine was similar to a rich adjacent mine, it was held that a subscriber was entitled to relief.[198] Similarly, it would be a misrepresentation in a prospectus to state that the company had a contract in place for the purchase of a property when, in fact, that arrangement was only in negotiation.[199] It is not a misrepresentation if the prospectus states that the capital is £*x* and the memorandum and articles contain the usual powers to increase or reduce the capital.[200] It has been held that a representation in a prospectus to the effect that the members of the company were comprised of "a large number of gentlemen in the trade and others", when only a

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[191] *Reese River, etc., Co. v. Smith* (1869) L.R. 4 H.L. 64.
[192] *Greenwood v. Leather Shod Wheel Co.* [1900] 1 Ch. 421.
[193] *Hyde v. New Asbestos Co.* (1891) 8 T.L.R. 121.
[194] *Stirling v. Passburg Grains, etc., Ltd* (1891) 8 T.L.R. 71.
[195] *Lagunas Nitrate Co. v. Lagunas Nitrate Syndicate* [1899] 2 Ch. 392, 397, 429.
[196] *Karberg's Case*[1892] 32 Ch. 1; *Beattie v. Ebury* (1874) L.R. 7 Ch. 777, 804; *Alderson v. Maddison* (1883) 3 App. Cas. 467; *Bellairs v. Tucker*(1884) 13 Q.B.D. 562.
[197] *Eddington v. Fitzmaurice* (1885) 29 Ch.D. 459, 483, per Bowen L.J.
[198] *Re Mount Morgan, etc., Ltd* (1887) 56 L.T. 622. There are a number of cases in which the benefits which the promoters stood to take from the company were concealed, thus constituting actionable misstatements: *Re London and Staffordshire Fire Insurance Co.* (1883) 25 Ch.D. 149; *Lodwick v. Earl of Perth* (1884) 1 T.L.R. 76; *Capel & Co. v. Sim's, etc., Co.* (1888) 58 L.T. 807; *Re Liberian Government Concessions, etc., Co.* (1892) 9 T.L.R. 136.
[199] *Ross Estates Investment Co.* (1868) L.R. 3 Ch. 682.
[200] *City of Edinburgh Brewery Co. Ltd v. Gibson's Trustees* (1869) 7 M. 886.

dozen out of a total membership of 55 were in fact in the trade, was not a material misrepresentation.[201]

Reports referred to in a prospectus

If the company takes it upon itself to assume the authenticity of the reports referred to in the prospectus and represents as facts the matters stated in those reports, it must take the consequences should they prove to be false.[202] So, in *Re Pacaya Rubber and Produce Co. Ltd*[203] the prospectus contained extracts from a report of a Peruvian expert as to the condition of rubber estate which the company sought to acquire. It was held that these extracts from the report contained in the prospectus formed the basis of the contract. On the basis that the company had not distanced itself from the report nor suggested that it did not vouch for the accuracy of the report, the company was taken to have contracted on the basis of the contents of the report. Therefore, the contracts of allotment could be rescinded.

Compensation under s.90 FSMA 2000

This section is concerned with the availability of compensation for loss occasioned by some defect in a prospectus as provided by s.90 of FSMA 2000. This provision expressly preserves any action under the general law.[204] Those actions under the general law were considered immediately above. Section 90 itself is sufficiently vague that it is suggested that the case law principles will still be important as an aid to the interpretation of that provision. First, we shall consider the people who are defined in the Prospectus Rules as being legally responsible for the preparation of the prospectus.

Persons responsible for the contents of the prospectus

The definition of the persons responsible for the contents of a prospectus or of a supplementary prospectus are set out in Chapter 5 of the Prospectus Rules.[205] The persons responsible for a prospectus are subject to the general duty of disclosure in s.87A of FSMA 2000. In relation to equity securities, the persons responsible for the prospectus are:[206] the issuer; directors and those authorising themselves to be named as responsible for the prospectus; any other person who accepts responsibility for the prospectus; in relation to an offer, each person who is a director of a body corporate making an offer of securities; in relation to applications for admission to trading, each person who is a director of a body corporate making an offer of securities; and other persons who have authorised the contents of the prospectus. In relation to securities which are not equity securities, the persons responsible for the prospectus are:[207] the issuer; anyone who accepts and is stated in the prospectus as accepting responsibility

[201] *Ibid*.
[202] *Reese River, etc., Co. v. Smith* (1869) L.R. 4 H.L. 64.
[203] [1914] 1 Ch. 542. See also *Mair v Rio Grande Rubber Estates Ltd* (1913) S.C. HL 74.
[204] Financial Services and Markets Act 2000, s.90(6).
[205] Prospectus Rules, chap. 5.
[206] Prospectus Rules, para 5.5.3R.
[207] Prospectus Rules, para 5.5.4R.

for the prospectus; any other person who is the offeror of the securities; any person who requests an admission to trading of transferable securities; any guarantor for the issue in relation to information about that guarantee; and any other person who has authorised the contents of the prospectus. That someone has given advice in a professional capacity about the contents of a prospectus does not make that person responsible for the contents of the prospectus in itself;[208] unless they consent to being so named or they authorise those contents of the prospectus which are the subject of the action, and even then they are liable only to the extent that they have agreed to be so liable.[209]

Compensation under s.90(1) of FSMA 2000 for loss due to a defect in a prospectus

The basis of the right to compensation under s.90 FSMA 2000

Section 90 of FSMA 2000 creates a means of acquiring compensation for defects in a prospectus which is not stated as being subject to all of the requirements of proximity, causation and foreseeability which arise in the common law, particularly on the case law decided before the creation of the Prospectus Rules. However, as set out above, this case law can now be read as being more expansive than hitherto. Nevertheless, s.90 constitutes an important development in the potential liability of those responsible for the preparation of a prospectus. Section 90(1) of FSMA 2000 provides that:

> 'Any person responsible for listing particulars is liable to pay compensation to a person who has
>
> > (a) acquired securities to which the particulars [or the prospectus] apply; and
> >
> > (b) suffered loss in respect of them as a result of
> >
> > > (i) any untrue or misleading statement in the [prospectus];
> > >
> > > (ii) or the omission from the [prospectus] of any matter required to be included by [the duties of disclosure in] section [*87A or 87B*]'.[210]

It is unclear whether any statement under paragraph (b)(i) of s.90(1) must be both untrue and also misleading, or whether liability attaches to a statement on grounds that it is either untrue or that it is misleading. It is suggested that because the word "or" is used in relation to them, and because the requirements of a statement being "untrue" are not necessarily the same as the requirements of it being "misleading", then they should be treated as being alternative heads of liability and therefore the word "or" should be considered to be disjunctive.[211] If so, there are three heads of liability resulting from this provision.

The first head of liability relates to untrue statements. It is not a requirement of the statutory language that there have been fraud or any other intention to deceive; rather,

[208] Prospectus Rules, para 5.5.9R.
[209] Prospectus Rules, para 5.5.8R.
[210] Financial Services and Markets Act 2000, s.90(1). Words in square brackets added by the author to reflect Financial Services and Markets Act 2000, s.90(11)(a) and the fact that this discussion focuses on prospectuses, and not the limited regime relating to listing particulars for offers only to expert investors.
[211] The word "or" can be conjunctive: for example, "he is happy being called Francis or Frank" suggests that the word "or" joins those two concepts. The word "or" is disjunctive in circumstances such as "he turned left or he turned right" when it suggests either one thing or alternatively another.

the statement made must have been untrue. Equally, the concept of "untrue" statements would seem to include statements which are "incorrect" and does not require that they be untrue as a result of some lie or deceit. It is enough that the loss arose "as a result of" the untrue statement; there is no explicit requirement of causation or foreseeability on the model ordinarily required for damages in tort at common law.

The second head of liability relates to misleading statements made in a prospectus. The element of causation in the statute is satisfied if the loss is "a result of" the misleading statement. It is not a requirement of the statutory language that there have been fraud or any other intention to deceive; rather, the statement made must have misled the claimant. As above, it is duty of the person responsible for the prospectus to ensure that all statements made in the prospectus or any omissions made from the prospectus are not likely to be misleading. The effect of this provision is therefore to place an implied obligation on those responsible for the contents of a prospectus not to make any misleading statements in that prospectus, whether advertently or inadvertently.

The third head of liability relates to the omission of material which would otherwise be required by the duty of disclosure in s.87A of FSMA 2000. The duty of disclosure is rooted in the requirement that the prospectus must contain the "necessary information" before it can be approved by the FSA.

Defences to liability under s.90

Schedule 10 to the FSMA 2000 then sets out the exemptions from liability for compensation under s.90. There are five possible defences to a claim under s.90 that a statement was incorrect or misleading and so caused a loss. The first defence applies when the defendant believed in the truth of the statement that was made in the prospectus.[212] The second defence applies when the statement was made by an expert which is included in a prospectus or a supplementary prospectus with that expert's consent and is stated in that document to be included as such.[213] The third defence requires the publication, or the taking of reasonable steps to secure publication, of a correction.[214] The fourth defence requires the taking of all reasonable steps to secure the publication of a correction of a statement made by an expert.[215] The fifth defence applies when the statement was made by an official person or contained in a public, official document, provided that the statement was accurately and fairly reproduced.[216] The sixth defence applies if the court is satisfied that the investor acquired the securities with knowledge that the statement was incorrect, and therefore that the investor was not misled by it.[217]

[212] Financial Services and Markets Act 2000, Sch. 10. para 1.
[213] Financial Services and Markets Act 2000, Sch. 10, para 2(1).
[214] Financial Services and Markets Act 2000, Sch. 10, para 3.
[215] Financial Services and Markets Act 2000, Sch. 10, para 2(3), and para 4.
[216] Financial Services and Markets Act 2000, Sch. 10, para 5.
[217] Financial Services and Markets Act 2000, Sch. 10, para 6.

The persons who can bring a claim under s.90 FSMA 2000

The category of potential claimants under s.90 includes any person who has acquired or who has contracted to acquire securities or any interest in some of the securities to which the defective prospectus relates.[218] Further that person must have suffered a loss in respect of the securities; and the loss must have been suffered as a result of the relevant untrue or misleading statement or omission.

Interpretation of s.90 of FSMA 2000 in the light of the decided cases

The foregoing sections of this chapter have considered the interpretation of s.90 on its own words. What is evident about the principles underpinning the common law from the nineteenth century was that they required the utmost good faith in the preparation of prospectuses because the prospectus was the only document on which the investor could rely when deciding whether or not to invest in an undertaking. As is considered below, this requirement of the utmost good faith went further than sanctioning the careful drafting of prospectuses so as to put a positive spin on every statement and so as to mask any unattractive information. The common law would not permit ambiguity and half-truth to save the draftsmen from liability. In the light of the Prospectus Rules it is suggested that s.90 should be interpreted as requiring an equally stringent standard of disclosure, or else it will always remain in the shadows behind the common law actions.

Section 90 ought to offer a greater means of establishing liability for compensation than the common law because the common law contains requirements as to causation and the burden of proof. In consequence, the range of causes of action available to a person who has acted in reliance upon misstatements in a prospectus is much wider now than then it was. Interestingly, while it was once thought that the “golden legacy” cases constituted an overly stringent code for preparing prospectuses, it is nothing compared to the formalism of modern securities regulation.

[218] Financial Services and Markets Act 2000, s.90(7).

CHAPTER 6.

TRANSPARENCY OBLIGATIONS

The role of transparency regulation

The rules considered in this section were created further to the Transparency Obligations Directive.[219] Their purpose is to maintain a flow of information to the investing public *after* securities have been admitted to trading on a regulated market. Principally the regulations are concerned with "voting information" in relation to shareholdings and comparable instruments so that investors can know who has ultimate control of a company in which they are considering investing. In this way it is expected that the transparency of the issuer will be maintained. (This discussion focuses on voteholder information, although the Directive extends to other sorts of information, such as accounts.)

The Transparency Obligations Directive[220] was implemented in the UK by means of Part 43 of the Companies Act 2006 ("CA 2006"). Part 43 of CA 2006 interpolates new provisions into Part 6 of FSMA 2000 alongside the prospectus rules considered above. Implementation of the directive is thus achieved by means of additions to Part 6 of FSMA 2000 and, in time, by the introduction of "Disclosure and Transparency Rules" ("DTR") as part of the *FSA Handbook* to give effect to the more detailed provisions both of the directive and of the Commission's technical regulation relating to the directive.

Issuer's disclosure obligations in relation to voteholder information

Section 89B(1) of FSMA 2000 empowers the FSA to make regulations which require that "voteholder information" is to be made known to the issuer and to the public. "Voteholder information" means "information relating to the proportion of voting rights held by a person in respect of the shares".[221] There is an obligation on the issuer further to FSA Disclosure and Transparency Rulebook at DTR, para 5.6 at the end of each calendar month during which there have been dealings in the securities to disclose "to the public" the total number of voting rights and capital in respect of each class of issued shares and also the total number of voting rights attaching to shares of the issuer which are held in treasury.[222]

The purpose of many of the transparency rules, and of sections 89B through 89E of FSMA 2000, is to treat all voting rights under common control as constituting a single block of voting rights. As defined in s.89F(4) FSMA 2000 "voting rights" are rights attaching to a share which permit the shareholder to vote at company meetings

[219] 2004/109/EC.
[220] This directive has been referred to as the "Transparency Directive" for some time in the literature but the Companies Act 2006 refers to this directive as the "Transparency Obligations Directive".
[221] Financial Services and Markets Act 2000, s.89B(3).
[222] DTR, 5.6.1R.

(provided that the shares at issue have been admitted to trading on a regulated market). Thus the transparency obligations provisions are concerned to enable investors to know who holds and who ultimately *controls* such rights, as well as to make transparent financial and other information about the company.

"Shares" in this context refers to shares carrying rights to vote at a general meeting of the company and which are admitted to trading on a regulated market.[223] The concept of "control" is defined by s.89J(2) FSMA 2000 so as to include the following categories of person: people who hold a majority of voting rights in other persons, or who have the right to alter the composition of another person's board of directors, or who control the voting rights in another person perhaps by virtue of some shareholders' agreement, or who either have a legal right to exercise a dominant influence over another person or who "actually exercise" a dominant influence over that other person.

Shareholders' obligations to make notification of voteholder information

The extended definitions of "shareholder" and "holder of voting rights"

Notification obligations extend beyond the owners of shares to people who, more specifically, hold shares with voting rights or who are able to control the use of voting rights in relation to shares.[224] By making transparent the underlying voting control in a company, the FSA regulations will enhance the transparency of that company's affairs. Thus, Part 43 of the Companies Act 2006 is concerned with control of voting rights as opposed to ownership of shares *per se*.[225]

A person holds voting rights in a company in the following three circumstances.[226] First, if they are a shareholder in the issuer. Secondly, if that person is entitled to deal with those voting rights under an agreement where parties are acting in concert in relation to the use of those shares, or where the shares are "lent"[227] or held as collateral,[228] or where the shares held on trust (whether subject to a life interest, or on discretionary trust or on bare trust), or where the rights in the shares are controlled by some other undertaking, or where control is exercised by an agent as a proxy. Thirdly, under a financial instrument which entitles the instrument holder to acquire voting rights in the issuer. As a fourth category, it is possible under the regulations that two or more people may be regarded as holding voting rights in respect of shares at the same time,[229] although it is not explained exactly on what basis those people are to be treated as owning the same voting rights simultaneously under s.89F(3) of FSMA 2000.

When notification must be made

Art 30 of the Transparency Obligations Directive requires that "a shareholder shall notify the issuer … of the proportion of voting rights and capital it holds … unless it has already

[223] DTR, 5.1.1R.
[224] Financial Services and Markets Act 2000, s.89F.
[225] Financial Services and Markets Act 2000, s.89F(1)(a).
[226] Financial Services and Markets Act 2000, s.89F(1)(b).
[227] Stock-lending is discussed in Alastair Hudson, *Law of Finance*, (Sweet & Maxwell, 2009), Ch.50.
[228] Collateralisation is discussed in Alastair Hudson, *Law of Finance*, (Sweet & Maxwell, 2009), Ch.45.
[229] Financial Services and Markets Act 2000, s.89F(3).

made a notification before that date". There is a cross-reference from this provision to Articles 9, 10 and 13 of the directive which relates to "Information about major shareholdings". Thus, the obligation to make notifications falls only on shareholders identified in Articles 9, 10 and 13 as holding major shareholdings carrying voting rights.

Article 9 requires notification on crossing thresholds of 5%, 10%, 15%, 20%, 25%, 30%, 50% and 75% of the total number of shares in an issuer which are "admitted to trading on a regulated market and to which voting rights are attached".[230] Notification is also required in relation to "events changing the breakdown of voting rights", such as the issue of new shares or the cancellation of shares.

Article 13 extends the notification provisions of Article 9 to situations in which the persons obliged to make notification of their shareholding actually hold "financial instruments", such as a physically-settled call option, which entitle them to acquire shares carrying voting rights.[231]

Further categories of information to be provided by issuers

The issuer of securities will be obliged by the FSA Disclosure and Transparency Rules to make notification of three types of information: periodic accounting information; information relating to the rights attached to the securities in question; and information about new loan issues and any connected guarantee or security,[232] under s.89C of FSMA 2000.

Powers exercisable in the event of an infringement of transparency obligations

The penalties for breach of any of the requirements of the preceding provisions are limited to the public censure of the issuer of the securities or to the power to suspend or prohibit trading in securities. Appeal from either of these penalties may be referred by the respondent to Tribunal created by FSMA 2000 to hear such matters under that Act generally.

Misleading statements in discharge of transparency obligations

Section 90A of FSMA 2000 provides for compensation to be paid in relation to untrue or misleading statements contained in, or in relation to omissions from, the annual financial reports, the half-yearly financial reports, or interim management statements which are required to be published by Articles 4, 5 and 6 of the Transparency Obligations Directive, as was discussed in Chapter 40. Thus s.90A in effect extends the effect of s.90 to the new dimension which is added to securities regulation by the Transparency Obligations Directive. Section 90A(2), introduced to the bill in its final stages, makes clear that the Act relates only to securities traded on regulated markets. Section 90A of FSMA 2000

[230] As implemented by Financial Services and Markets Act 2000, s.89B(4). See also DTR, 5.1.2R in relation to significant changes in shareholdings.
[231] These principles are implemented by the FSA Rulebook at DTR, 5.3.
[232] Financial Services and Markets Act 2000, s.89C(2).

provides that the issuer of securities will be liable to "pay compensation" to any person who has both

> '(a) acquired such[233] securities issued by it, and
> (b)suffered loss in respect of them as a result of-
>> (i) any untrue or misleading statement in a publication to which this section applies, or
>> (ii) the omission from any such publication of any matter required to be included in it.'[234]

There is one important caveat to the issuer's liability, however. As provided in s.90A(4):

> 'The issuer is so liable only if a person discharging managerial responsibilities within the issuer in relation to the publication-
>> (a) knew the statement to be untrue or misleading or was reckless as to whether it was untrue or misleading, or
>> (b) knew the omission to be dishonest concealment of a material fact.'[235]

Therefore, the basis of liability is predicated, first, on the making of an untrue or misleading statement and, secondly, also the requisite knowledge of someone discharging managerial responsibilities within the issuer.

It is provided in s.90A(6) of FSMA 2000 that the defendant issuer is not to be liable for "any other liability than that provided for" by the preceding provisions of s.90A of FSMA 2000.[236] It is provided further in s.90A(7) that: '[a]ny reference to … a person being subject to a liability includes a reference to another person being entitled as against him to be granted any civil remedy or to rescind or repudiate an agreement.' Nevertheless, s.90A(8) provides that s.90A "does not affect … (b) liability for a civil penalty; [or] (c) liability for a criminal offence.' The meaning of these provisions when read together is unclear. At first blush, it is not clear is whether it is all obligations, including obligations at common law or in equity relating to loss, which are to be excluded; or whether it is only obligations under FSMA 2000 which are to be excluded. However, s.90A(7) suggests that it is all civil remedies which are to be excluded, seemingly unless they are "civil penalties" (such as those relating to market abuse) which are saved by s.90A(8). What is unclear then, is which civil actions may be saved and which excluded by s.90A of FSMA 2000.

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[233] The reference to "such securities" seems to be a reference to the particular securities which have been issued and in relation to which the loss must have been suffered.
[234] Financial Services and Markets Act 2000, s.90A(3).
[235] Financial Services and Markets Act 2000, s.90A(4).
[236] Financial Services and Markets Act 2000, s.90A(6).

CHAPTER 7.

THE LISTING RULES

(IN OUTLINE)

INTRODUCTION

The Official List of securities is the principal market for the securities of public limited companies which is open to the public. Securities on this list include shares, bonds, convertible bonds, warrants, securitised derivatives, and other securities as set out in this chapter. These securities are admitted to the trading on the London Stock Exchange's Main Market in the UK.

The statutory regime governing the official listing of securities is contained in Part 6 of FSMA 2000, comprising sections 72-103. The Official List in the UK is the list maintained by the "competent authority" under the EC *securities directives* for the purposes of Part 6.[237] The FSA is the UK Listing Authority ("UKLA") in this context. It is responsible for the maintenance of the Official List in the UK and also has the responsibility for the creation of listing rules. The Official List is regulated by means of the *FSA Listing Rules*.

Remember, securities may only be offered to the public once a prospectus has been approved by UKLA; once UKLA has admitted those securities to the Official List; and in compliance with the control on advertisements contained in the FSA's financial promotion rules.

THE DEFINITION OF "OFFERS OF SECURITIES TO THE PUBLIC"

The meaning of an "offer to the public"

Securities transactions are contracts between buyers and sellers of those securities. In relation to an issue of securities, it is the issuer which is making the issue. In relation to subsequent purchases of those securities from someone other than the original issuer (known as the "after market") there will be an offer by that seller and there will also be the continuing documentary representations in the form of a prospectus made by the issuer at the time of the *initial public offering*. The focus of securities regulation is on offers of securities to the public. Therefore, this section defines the circumstances in which an offer is made to the public, with the result that they are governed by the FSA *securities regulations*. The term "offer of transferable securities" is defined in s.102B(1) of the Financial Services and Markets Act 2000 ("FSMA 2000"); and it is further hedged

[237] Financial Services and Markets Act 2000, s.72: which came into effect on 18th June 2001: Financial Services and Markets Act 2000 (Commencement No.3) Order 2001 (SI 2001 No 1820).

in by the exemption of certain offers of securities in Schedule 11A of FSMA 2000. Each is considered in turn.

The definition of "securities" and "transferable securities"

For the purposes of the Prospectus Directive 2003, the term "securities" is defined so as to mean:[238]

> '- shares in companies and other securities equivalent to shares in companies,
> - bonds and other forms of securitised debt which are negotiable on the capital market [sic] and
> - any other securities normally dealt in giving the right to acquire any such transferable securities by subscription or exchange or giving rise to a cash settlement
> excluding instruments of payment.'

However, the Prospectus Directive provides that national legislation may supplement this definition.[239] The listing rules refer generally to "transferable securities". The definition of "transferable security" in the Glossary to the *FSA Handbook* is "anything which is a transferable security for the purposes of MiFID, other than money-market instruments for the purposes of that directive which have a maturity of less than 12 months". The indicative definition[240] of "transferable security" in MiFID is:[241]

> ' "Transferable securities" means those classes of securities which are negotiable on the capital market, with the exception of instruments of payment, such as:
>
> (a) shares in companies and other securities equivalent to shares in companies, partnership or other entities, and depositary receipts in respect of shares;
> (b) bonds or other forms of securitised debt, including depositary receipts in respect of such securities;
> (c) any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures'

To summarise recklessly, this definition encompasses shares, bonds, and securitised derivatives respectively. (The detail of these products is outwith the scope of this course.)

The meaning of 'an offer of transferable securities to the public'

There is an "offer of transferable securities to the public", as defined in s.102B(1) of FSMA 2000, in the following circumstances:

[238] Prospectus Directive, art. 2(1)(a), as supplemented by the definition in Art 1(4) of Directive 93/22/EEC.
[239] Prospectus Directive, art. 2(1)(a).
[240] "Indicative" in the sense that we are told only what is included with the concept "transferable securities" rather than being given a comprehensive definition of the term.
[241] MiFID, art.4(18).

> ‘For the purposes of [Part 6 FSMA 2000] there is an offer of transferable securities to the public if there is a communication to any person which presents sufficient information on—
>
> (a) the transferable securities to be offered, and
>
> (b) the terms on which they are offered,
>
> to enable an investor to decide to buy or subscribe for the securities in question.’

Therefore s.102B FSMA 2000 has the effect that an offer to the public is made if there is an offer to only one person and (impliedly) if that offer is not an exempt offer within Part 6 of FSMA 2000.

Matters which fall outside the notion of an offer of transferable securities

A relevant offer is made where that offer is made to the public and where that offer is not an exempt offer.[242] This definition is meant to be a wide one so that it will catch all circumstances in which an issuer seeks to sell or market securities to the public generally. Only offers which are not made to the public at large or which fall into one of the statutory categories of exemption under s.86 of FSMA 2000 or under Sch.11A of FSMA 2000 are excluded from this legislation. Consequently, offers made in relation to government and public securities, offers made in relation to securities issued by not-for-profit organisations, and offers below identified amounts, are not considered to be offers of “transferable securities” within the prospectus regulations.

Private Companies May Not Offer Securities to the Public

A private company – that is, a company which is not a public company[243] – which is limited by shares or limited by guarantee may not “offer to the public any securities of the company” nor “allot or agree to allot any securities of the company with a view to their being offered to the public”.[244] It is a cornerstone of securities law that offers of securities to the public may only be made by public companies which are expressly subject to the FSA securities regulations. An “offer to the public” is defined by s.756 of CA 2006 so as to include an offer made to a section of the public. Offers which are not to be regarded as being offers to the public are offers which, after consideration of all the appropriate circumstances, are “not calculated to result, directly or indirectly, in securities … becoming available to persons other than those receiving the offer” or are “otherwise … a private concern of the person receiving [the offer] and the person making it”.[245]

[242] Financial Services and Markets Act 2000, Sch. 11, para 1(1).
[243] Companies Act 2006, s.4(1).
[244] Companies Act 2006, s.755(1).
[245] Companies Act 2006, s.756(3).

Introduction

This section considers the core principles which underpin the Listing Rules and by reference to which those rules are interpreted. The framework principles which guide the interpretation of the Listing Rules are the "Listing Principles".

The Listing Principles - imposing general obligations on the issuer

The role of the Listing Principles

Chapter 7 of the Listing Rules introduced the "Listing Principles" to the FSA regime for the first time in 2005 reform of those regulations. The general purpose behind the creation of these Listing Principles is to acknowledge the important role which listed companies play in ensuring the proper regulation of the securities markets in that the proper conduct of issuers and the proper provision of information is essential to the integrity of the securities markets. To this effect, the listing rules provide that:[246]

> 'The purpose of the Listing Principles is to ensure that listed companies pay due regard to the fundamental role they play in maintaining market confidence and ensuring fair and orderly markets.'

Further, the listing rules provide that:[247]

> 'The Listing Principles are designed to assist listed companies in identifying their obligations and responsibilities under the listing rules and the disclosure rules and transparency rules.'

So, the Listing Principles are educative as well as instructive. The six Listing Principles operate as follows.

The detailed Listing Principles themselves

The first principle requires that a "listed company must take reasonable steps to enable its directors to understand their responsibilities and obligations as directors", thus throwing a light on the significant role of a company's management in complying with the issuer's listing obligations. The "issuer" legally-speaking is the company which issues the securities, but it is that company's officers who are actually responsible for that organisation complying with its obligations. In ordinary company law, it is convenient to think of the company as being a distinct legal person because this simplifies the business of companies and it reduces the risks borne by shareholders;[248] but in relation

[246] Listing Rules, 7.1.2G.
[247] Listing Rules, 7.1.3G.
[248] The business of companies is simplified by not needing to have each contract signed by each director and so on: rather the company can act on its own. The risks of shareholders are reduced in relation to a limited company by the company itself taking on all the legal risk of dealing with third parties, instead of imposing any of that risk on the shareholders personally.

to securities law there can be no avoiding the fact that it is the human agents of a company, principally its directors, who control its actions and therefore it is those same human agents who must be trained to understand what securities law requires of the entity. In this sense, securities law cannot be content with the economically useful fiction of the separate personality of companies: rather, we must recognise that it is the human agents who control the activities of the company. This may require the training of directors and other employees, and it may require the creation of adequate internal systems to ensure compliance with the listing rules. This feeds into the second principle.

The second listing principle requires that a “listed company must take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations”. The concern for securities regulation is that adequate information is made available to the investing public and that companies remain transparent. Consequently, it is important that the internal procedure and the culture of a listed company ensures the full disclosure of all material which it is necessary for a listed company to disclose under the listing rules. Therefore, there need to be procedures for making information available – such that the necessary employees of the company know what is expected of them – and there is also a need that there are controls within a company to ensure that no-one in a position of authority is able to prevent the publication of such information, and so on. Let us take an example from the USA. One of the things which must be made available to investors is financial information which gives a true and fair view of the state of the listed company. In both Enron and in WorldCom in the USA there was a group of very senior executives who were able to control and thus to falsify the company’s financial information so that the company was restating long-term liabilities as being current profits. A company’s controls must not only allocate responsibility for identifying and publishing requisite information, but adequate controls must ensure that that information is not blocked, altered or otherwise interfered with.

What is difficult here is knowing what is meant in the abstract by the “reasonable steps” which a listed company is required to take in ensuring that it has appropriate internal controls and so forth. The regulations do not give detailed instruction on such points, but instead require listed companies, their agents and professional advisors to take a reasoned view on what is “reasonable” in any context. The minimum would seem to require the use of external advisors, the dilution of the power of senior executives in sensitive areas with the use of non-executive directors, the creation of a culture in which “whistleblowers” are taken seriously, and ensuring adequate training for directors and other advisors in sensitive departments as to the sorts of action and publication which are required.

The third principle for listed companies mirrors the central principle of “integrity” governing regulated financial institutions in the FSA *Principles for Businesses* rulebook in that it requires that a “listed company must act with integrity towards holders and potential holders of its listed equity securities”. Whereas the now-repealed 2002 Listing Rules focused on the need for sponsors to introduce elements both of professionalism and integrity to an application for admission to listing, the 2007 Listing Rules have broadened those requirements of integrity out to issuing companies as well as their sponsors, whilst also continuing to rely on sponsors for the professionalism and the integrity expected of “authorised persons” regulated by the FSA. The word “integrity” means “freedom from moral corruption … [s]oundness of moral principle; the character of uncorrupted virtue; uprightness, honesty, sincerity.'[249] In relation to issuers of securities this clearly requires compliance in the utmost good faith with requirements that all information necessary to make an informed decision about whether or not to acquire securities (as required by the Prospectus Rules) and to provide information as to shareholders and voting control on an on-going basis (as required by the Transparency Rules).

The fourth principle then sets out the need for a listed company to "communicate information to holders and potential holders of its listed equity securities in such a way as to avoid the creation or continuation of a false market in such listed equity securities". The term "false market" is not defined in the listing rules. It is suggested that one useful interpretation of this term would be to think of the listed company as being obliged to disclose any information which an investor or his professional advisors would ordinarily require to make an informed decision about whether or not to invest in the given equity securities. Failure to disclose such material, it is suggested, would cause an investor to make investment decisions otherwise than on a correct basis: in that sense it would be a "false" market.

The fifth principle provides that a "listed company must ensure that it treats all holders of the same class of its listed equity securities that are in the same position equally in respect of the rights attaching to such listed equity securities". Thus, equity must be preserved between the holders of shares (equity securities) in relation to voting and other rights. The sixth principle stipulates that a "listed company must deal with the FSA in an open and co-operative manner". This principle appears to operate in parallel with the third listing principle relating to acting with "integrity". The ramification of failing to be open and co-operative will be that the listed company will be in breach of its obligations under the listing rules.

[249] There are, in the interests of full disclosure, two other senses of the word integrity, which it is suggested are of no interest in this context, relating to "completeness" and not being married nor violated.

CHAPTER 8.

CONTINUING OBLIGATIONS

ADMISSION TO LISTING

Conditions as to the nature of the issuer itself

The preconditions for making an application for listing

The procedure for admission to listing requires that an applicant comply with the listing rules. An application for listing must be made in accordance with s.75 of FSMA 2000 to the effect that:[250]

> 'Admission to the official list may be granted only on an application made to the competent authority in such manner as may be required by listing rules.'

That is, the application must be made to the FSA as the UK's competent authority (referred to as UK Listing Authority ("UKLA") in this chapter) in such a manner as the listing rules generally may require.[251] As is considered below, the Listing Rules impose general conditions on all listed securities.

General conditions for admission to listing

The conditions to be fulfilled by the applicant before the applicant's securities will be admitted to listing are numerous. These conditions operate in effect as conditions precedent to the authorisation of admission to listing. It is in chapters 2 and 6 of the Listing Rules that the principles dealing with the pre-requisites for admission to listing are set out. The company is required to be duly incorporated,[252] and the securities must have been duly authorised for listing under the company's constitution,[253] the shares must be freely transferable,[254] and the shares must be admitted to trading on an RIE's market for listed securities.[255] The issuer's securities must have a minimum capitalisation.[256] Significantly, an approved prospectus must be published.[257]

The second tranche of information relates to the company's financial condition. The company must have published and filed audited accounts for at least three previous

[250] Financial Services and Markets Act 2000, s.75(1).
[251] Financial Services and Markets Act 2000, s.75(1).
[252] Listing Rules, 2.2.1R.
[253] Listing Rules, 2.2.2R.
[254] Listing Rules, 2.2.4R.
[255] Listing Rules, 2.2.3R.
[256] Listing Rules, 2.2.7R.
[257] Listing Rules, 2.2.10R.

years,[258] the company must have an independent business and the company's business activities must have continuous for the previous three years,[259] and it must have a minimum working capital identified in the rules.[260] The securities themselves must be 25% in public hands after the issue within the EU and EEA,[261] and they must be capable of electronic settlement.[262]

Special conditions on a particular listing application

The Listing Rules empower UKLA to impose special conditions on any application for listing. CARD provides that any special conditions should be used "solely in the interests of protecting investors" and so may relate, for example, to the provision of particular information necessary to keep the investing public informed about the issuer's business activities.[263] Admission to listing may not be permitted unless and until those general conditions and any special conditions have been complied with.[264]

That the issuer must have consented to the listing

It is a pre-requisite that the entity which is issuing the securities must have consented to the application for listing.[265] So, for example, one of the shareholders or one of the directors cannot decide on her own volition to have those securities listed.

Conditions to be satisfied in relation to the securities themselves

There are further requirements which must be met by the securities themselves. The first requirement is that for securities to be listed they must be admitted to trading on a recognised investment exchange's market for listed securities.[266]

The second requirement is that the securities must be validly issued according to the law of the place of the applicant's incorporation, they must accord with the entity's memorandum and articles of association, and any necessary statutory or regulatory consents must have been obtained.[267] Furthermore, the securities must be "freely transferable".[268] It is also a requirement of the admission of securities to listing that those securities are eligible for electronic settlement.[269]

[258] Listing Rules, 6.1.3R.
[259] Listing Rules, 6.1.4R.
[260] Listing Rules, 6.1.16R.
[261] Listing Rules, 6.1.19R.
[262] Listing Rules, 6.1.23R.
[263] CARD, art 12.
[264] Financial Services and Markets Act 2000, s.75(4); and Listing Rules, Chap.2, para 2.1.2G.
[265] Financial Services and Markets Act 2000, s.75(2).
[266] Listing Rules, Chap. 2, para. 2.2.3R.
[267] Listing Rules, Chap. 2, para. 2.2.2R. See CARD arts. 45 and 53.
[268] Listing Rules, Chap. 2, para. 2.2.4(1)R. Special provision is made for partly paid securities and for permission to be granted (by the competent authority) to disapprove the transfer of shares. See CARD, arts 46, 54, and 60.
[269] Listing Rules, 6.1.23R.

The third set of requirements relate to the total market capitalisation of that class of securities. Except where securities of the same class are already listed, the expected aggregate market value of all securities to be listed must be at least £700,000 for shares and £200,000 for debt securities.[270] However, "the UK Listing Authority may admit securities of lower value if satisfied that there will be an adequate market for the securities."[271] Whether or not there is an adequate market for the securities will depend on the circumstances of the particular issue.

The application procedure for admission to the Official List

The Listing Rules contain a detailed application procedure for companies to gain admission to listing in Chapter 3, setting out all of the documents which must be lodged with the FSA before, in accordance with its guidance notes, the FSA will consider the application. There are different, detailed rules for different types of security.[272] UKLA guidance provides that it will consider applications only once all the documentation has been delivered, and that UKLA will consider any and all information which it considers appropriate, possibly going beyond the documentation which has been lodged with it in accordance with chapter 3 of the Listing Rules.[273] This may result in UKLA conducting enquiries, verifying the accuracy of the documentation, and requesting any further information which it requires. UKLA may then impose any further conditions on the application which it considers appropriate.[274] In the ordinary case of events, the specified documents must be lodged by the issuer at least two business days prior to UKLA hearing the listing application (hence them being known as "the 48 hour documents"),[275] including the application for listing in prescribed form, any declaration required from a sponsor, and a copy of the prospectus, and any other document required by the regulations in that context.[276] Other documentation may include a copy of any circular which has been published in connection with the application;[277] any approved supplementary prospectus;[278] a copy of the board resolution of the issuer allotting the securities;[279] any accounts or interim financial statement; and so on.

The role of sponsors in listing applications

The requirement for a sponsor

There is a requirement for a sponsor in relation to any listing. Sponsors are usually regulated investment firms which are required, in effect, to vet the suitability of an issue of securities, and to warrant that suitability to the FSA. It is a requirement of seeking admission to the Official List that each listed company has a sponsor:[280] the sponsor in

[270] Listing Rules, Chap. 2, para 2.2.7(1)R.
[271] Listing Rules, Chap. 2, para 2.2.8G. See CARD, arts 43 and 58.
[272] See Alastair Hudson, *Securities Law* (Sweet & Maxwell, 2008), Part 4 generally.
[273] All of the material considered in this paragraph is set out at Listing Rules, chap. 3, para. 3.2.6G.
[274] Listing Rules, chap. 3, para. 3.2.6(5)G.
[275] Listing Rules, chap. 3, para. 3.3.2R.
[276] Listing Rules, chap. 3, para. 3.3.2R.
[277] Listing Rules, chap. 3, para. 3.3.2(3).
[278] Listing Rules, chap. 3, para. 3.3.2(4).
[279] Listing Rules, chap. 3, para. 3.3.2(5).
[280] Listing Rules, chap. 8, para 8.2.1R.

turn will be required to have sufficient professional expertise in securities issues to be authorised to act as such by the FSA. The sponsor's primary role is to assist the issuer to bring an issue of securities before the market. However, the sponsor has an equally significant secondary role, as expressed in the listing rules, in supplying information to UKLA and also requiring the sponsor to certify and to ensure that the listing rules have been complied with by the issuer during the application process and thereafter.

UKLA maintains a list of approved sponsors on its web-site.[281] To be included on the list of approved sponsors, the sponsor must be authorised under the Financial Services and Markets Act 2000[282] or must be a person regulated by a professional body recognised by that Act.[283]

There are four principles governing the activities of sponsors. First, the sponsor must exercise due care and skill in advising the listed company as to its obligations under the securities regulations.[284] Secondly, the sponsor must take reasonable steps to ensure that the directors of the listed company understand the nature and extent of their obligations under the listing rules.[285] Thirdly, the sponsor must deal with the FSA in an open and co-operative manner, dealing promptly with all of the FSA's enquiries and disclosing any "material information" of which it has knowledge to the FSA in a "timely manner".[286] Fourthly, the sponsor is required to be independent of the listed company[287] and to complete a form attesting to its independence in relation to each admission for listing in which it participates.[288] The definition of independence here requires that the sponsor not own more than 30% of the equity of the listed company nor have a "significant interest" in the listed company's debt securities.[289]

In relation to an issue the sponsor is required to form the "reasonable opinion", after making due and careful inquiry, that the applicant has satisfied all of the requirements of the Listing Rules and of the Prospectus Rules, that the directors of the applicant have put in place adequate procedures to enable the applicant to comply with the listing rules, and that the directors of the applicant have also put in place procedures on the basis of which they are able to make "proper judgments on an ongoing basis" as to the applicant's financial position and prospects.[290]

General Continuing Obligations in the Listing Rules

Rules which must be complied with on a continuing basis

The Listing Rules create a number of rules which can be understood as continuing obligations. The securities which are listed must continue to be admitted to trading on a

[281] Listing Rules, chap 8, para 8.6.1G.
[282] Listing Rules, chap 8, para 8.6.2R.
[283] Listing Rules, chap 8, para 8.6.5R.
[284] Listing Rules, chap 8, para 8.3.3R.
[285] Listing Rules, chap 8, para 8.3.4R.
[286] Listing Rules, chap 8, para 8.3.5R.
[287] Listing Rules, chap 8, para 8.3.6R.
[288] Listing Rules, chap 8, para 8.7.12R.
[289] Listing Rules, chap 8, para 8.3.6R.
[290] Listing Rules, chap. 8, para 8.4.2R.

regulated market.[291] The securities must also remain in public hands as to 25% of their number.[292] The company must comply with the Disclosure and Transparency Rules – specifically relating to the publication of inside information – while its securities are listed.[293]

Continuing obligations to keep the FSA informed of administrative matters

The company is required to keep the FSA informed of two kinds of administrative information. The company must provide the FSA with contact details of a person who is to be the first point of contact between the FSA and the company.[294] The company must also provide the FSA with two copies of any mooted amendment to its constitution.[295]

Continuing obligations as to the equal treatment of shareholders

The company is required to treat each of its shareholders equally, in accordance with the fifth Listing Principle. The Listing Rules formerly required that information must be provided to all shareholders equally.[296] Those rules have now been revoked, although the fifth Listing Principle remains. It is suggested that the revocation of these rules should not be interpreted as a general permission to discriminate unreasonably between different classes of shareholders, nor between different individual shareholders. The position of existing shareholders is also required to be protected by reference to the right of pre-emption of existing shareholders in s.561 of the Companies Act 2006, which means that new shares must be offered to existing shareholders first. The City Code on Mergers and Takeovers also requires the equal treatment of shareholders in takeover situations.

Continuing obligations relating to financial information

Listed companies must publish a preliminary statement of their annual results as soon as such a statement has been approved, in any event within 120 days of the end of the period to which it relates.[297] This information must be published through a recognised information service once those matters have been agreed with the company's auditors, together with any decision as to the payment of a dividend.[298] However, the FSA may authorize the omission of any of this information if its disclosure would be either "contrary to the public interest or seriously detrimental to the listed company".[299] This power to condone omission of information is nevertheless subject to a proviso that the omission would not be "likely to mislead the public with regard to facts and circumstances, knowledge of which is essential for the assessment of the shares".[300]

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[291] Listing Rules, 2.2.3R.
[292] Listing Rules, 6.1.19R
[293] Listing Rules, 9.2.6R.
[294] Listing Rules, 9.2.11R.
[295] Listing Rules, 9.2.14R.
[296] Listing Rules, 9.3.1R.
[297] Listing Rules, Chap. 9, para 9.7.1R.
[298] Listing Rules, Chap. 9, para 9.7.2R.
[299] Listing Rules, Chap. 9, para 9.7.3R.
[300] Listing Rules, Chap. 9, para 9.7.3R.

The range of continuing obligations in relation to market abuse

Market abuse is considered below.

The continuing obligations in the FSA Disclosure and Transparency Rules

In general terms, the FSA Disclosure and Transparency Rules oblige an issuer to notify a recognised information service "as soon as possible"[301] of any inside information which "directly concerns the issuer",[302] unless the issuer (on its own initiative) considers the prevention of disclosure to be necessary to protect its own "legitimate interests".[303] This requirement of disclosure is in common with the fifth Listing Principle. The obligation is then to make disclosure of any inside information so that the entire market has equal access to the same information. The definition of inside information is considered below in relation to insider dealing.

The obligation to communicate information

The fourth of the Listing Principles provides that:

> 'A listed company must communicate information to holders and potential holders of its listed equity securities in such a way as to avoid the creation or continuation of a false market in such listed equity securities.'

There are a number of matters about which a listed company must make disclosure either at the time of making an issue of securities or on a continuing basis thereafter. The keynote here is the avoidance of the creation of a "false market" in the equity securities at issue.

The requirement for circulars

Circulars are required to be circulated to holders of equity securities by chapter 13 the Listing Rules in a number of circumstances. A circular may incorporate by reference any information in a prospectus or any other document which has been published and filed with the FSA.[304] Circulars are required in a number of circumstances, many of which are those set out in section 13.8 of the Listing Rules. Circulars are required *inter alia* in relation to votes connected with the authority to allot shares, disapplying pre-emption rights in relation to the allotment of shares, increasing authorised share capital, reducing the company's capital, in relation to a capitalisation or bonus issue, in relation to a scrip

[301] This will be satisfied if the issuer acted as soon as was possible in the circumstance of factors which were only gradually coming to light: Disclosure and Transparency Rules, Chap. 2, para, 2.2.2R. A short delay in publication of the information will be acceptable if it is "necessary to clarify the situation": Disclosure and Transparency Rules, Chap. 2, para, 2.2.9G.
[302] Disclosure and Transparency Rules, Chap. 2, para, 2.2.1R.
[303] Disclosure and Transparency Rules, Chap. 2, para, 2.5.1R. See Market Abuse Directive, art. 6(1).
[304] Listing Rules, 13.1.3R.

dividend, giving notice of meetings, making amendments to the company's constitution, in relation to an employees' share scheme, in relation to discounted option arrangements, in relation to reminders of conversion rights over convertible securities; and in various contexts to do with takeovers and mergers.

Penalties for breach of the Listing Rules

There are two potential penalties for breach of the listing rules as provided in s.91 of FSMA 2000. The first arises when there has been any contravention of the listing rules such that the issuer, or any of its managers or any person connected to a manager, is subject to such penalty as the FSA thinks fit. Liability for a second form of penalty arises under s.91(1A) of FSMA 2000 when there has been a contravention of Part 6 of FSMA 2000 or of the Prospectus Rules:the penalty is such as the FSA considers appropriate.

Duties of disclosure relating to prospectuses and transparency obligations

All of the regulations under the prospectus rules and the transparency rules, considered above, should be considered as being continuing obligations.

DISCONTINUANCE OF LISTING

The FSA has four separate powers under FSMA 2000 to prohibit or suspend or otherwise control securities transactions: first, a power to discontinue or to suspend listing further to s.77 of FSMA 2000; second, a power suspend or prohibit an offer of transferable securities to the public under s.87K of FSMA 2000; third, a power to suspend or prohibit admission to trading on a regulated market under s.87L of FSMA 2000; and, fourth, a power to suspend trading in a financial instrument on grounds of breach of the disclosure rules under s.96C of FSMA 2000. Guidance on the operation of those provisions is then given in the listing rules and the disclosure rules. In art.18(1) of CARD it is provided that UKLA "may decide to suspend the listing of a security where the smooth operation of the market is, or may be, temporarily jeopardised or where protection of investors so requires":[305] language which is adopted in the listing rules.[306] The procedure for either discontinuance or suspension of listing is set out in s.78 of FSMA 2000 and in the FSA 'Decision Making Manual ("DEC")',[307] requiring that a written notice in the appropriate form be given to the company once a decision to discontinue listing has been taken. The notice must give reasons for the discontinuance. UKLA must invite representations from the issuer in relation to the notice to discontinue or suspend,[308] and inform the issuer of a right of referral to the Tribunal, informing the issuer of the procedure for such a referral.[309] A procedure for appeal is thus created.

[305] CARD, art.18(1).
[306] Listing Rules, chap. 5, para 5.1.1(1)R.
[307] Listing Rules, Chap.5, para.5.5.1G.
[308] The period for receipt of representations may be extended by the competent authority: Financial Services and Markets Act 2000, s.78(4).
[309] Financial Services and Markets Act 2000, s.78(7).

CHAPTER 9.

MARKET ABUSE AND INSIDER DEALING

INTRODUCTION:
INSIDER DEALING, MARKET MANIPULATION & MARKET ABUSE

This chapter is concerned with the criminal offences relating to *insider dealing* and *market manipulation*;[310] and the FSA civil regulation of *market abuse*. The criminal offences seek to punish people who use "inside information" about quoted companies which has not yet been made public when dealing in securities (that is, "insider dealing" under Part V of the Criminal Justice Act 1993 ("CJA 1993")[311]), or who seek to manipulate a market by making a misleading statement (that is, "market manipulation" further to s.397 of the Financial Services and Markets Act 2000 ("FSMA 2000")). Insider dealing is particularly difficult for the authorities to identify and there have consequently been very few prosecutions. Therefore, the insider dealing code has been supplemented by the FSA regulation of "market abuse"[312] and a power under FSMA 2000 to impose "civil penalties" on transgressors.[313] The aim of these extensions to the criminal law's insider dealing regime has been to move the burden of combating misuses of inside information to the FSA, as regulator for the securities markets in the UK, so that the FSA can work in tandem with the criminal law. The law on "market abuse" generally can be thought of as forming a single topic covering the criminal law on insider dealing and market manipulation, together with the FSA the regulation of market abuse. The regulation of market abuse further is conducted by the FSA further to s.118 *et seq*. of FSMA 2000.

INSIDER DEALING

The insider dealing provisions

The statutory provisions on the criminalisation of insider dealing are contained in Part V of the Criminal Justice Act 1993 ("CJA 1993"), comprising sections 52-64 and Schedules 1 and 2 of that Act.[314] Part V was passed to enforce the provisions of the EC Insider

[310] Parts of this chapter are based on parts of Chapter 26 of Alastair Hudson, *Securities Law* (Sweet & Maxwell, 2008).
[311] See para 14-03.
[312] Market abuse was considered in detail in Chapter [].
[313] A form of quasi-criminal power to impose penalties which has been granted to the Financial Services Authority ("the FSA") by Part VIII of the Financial Services and Markets Act 2000 as considered below.
[314] See generally B. Rider and M. Ashe, *Insider Crime – The New Law* (Jordans Publishing, 1993); B. Rider, K. Alexander and L. Linklater, *Market Abuse and Insider Dealing* (Tottel Publishing, 2002). There are shorter discussions of this topic in the following: P. Wood, *Regulation of International Finance* (Sweet & Maxwell, 2007), Chapter 21.

Dealing Directive[315] the preamble to which set out the purpose of the legislation to be to provide an “assurance afforded to investors that they are placed on an equal footing and that they will be protected against the improper use of inside information”. The concept “inside information” is also used in relation to market abuse[316] and in relation to the Model Code in the FSA Disclosure and Transparency Rules.[317]

There are two statutory objectives underpinning the insider dealing code: first, the protection of the integrity of the securities markets and, secondly, ensuring that in any securities transaction there is no imbalance of information between the buyer and the seller of that security. These underlying objectives in the legislation is considered below.[318]

The three offences

The offences in outline

There are three offences relating to insider dealing. The principal focus of the offence in s.52(1) CJA 1993 is on individuals who deal in “price-affected” securities using information which they gleaned as an “insider”. (All of these terms will be discussed shortly.) The second offence relates to encouraging others to deal in price-affected securities. The third offence relates to disclosing inside information. There are then a range of defences to these offences. Each element is considered in turn in the sections to follow.

The power of the Financial Services Authority

Further to the enactment of the Financial Services and Markets Act 2000 (“FSMA 2000”), the Financial Services Authority has the power to prosecute any allegations of insider dealing.[319] Thus, the day-to-day regulator of the securities markets is given an inquisitorial and prosecutorial power in relation to insider dealing, which operates in tandem (it is suggested) with its powers to regulate market abuse more generally.

The principal offence of insider dealing in s.52(1) CJA 1993

The elements of the offence under s.52(1) CJA 1993

The principal offence of “insider dealing” is contained in s.52(1) CJA 1993. Each expression in that subsection is defined elsewhere in the Act, and therefore we shall begin with s.52(1) before considering each of the component terms separately. The principal offence in s.52(1) is expressed in the following terms:

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[315] 89/592/EC, [1989] O.J. L334/30.
[316] See para .
[317] See para .
[318] See para
[319] Financial Services and Markets Act 2000, s.402.

'(1) An individual who has information as an insider is guilty of insider dealing if, in the circumstances mentioned in subsection (3), he deals in securities that are price-affected securities in relation to the information.'

The elements of the offence are therefore as follows. First, the offence is committed by an individual (that is, a human being[320]). Secondly, that individual must have information as an "insider", as is defined below, as opposed to having that information in any other way. There are other offences dealing with non-insiders considered below.[321] Thirdly, the individual must "deal" in securities, as is defined below. Fourthly, the securities in which the individual deals must be "price-affected securities", as is defined below. Fifthly, those securities must be price-affected securities "in relation to the information", and not coincidentally price-affected due to some other factor. Thus, the insider must be dealing in relation to information which itself affects the price of the securities. Sixthly and furthermore, these activities must be performed in the circumstances set out in s.52(3):-

'(3) The circumstances referred to above [in s.52(1)] are that the acquisition or disposal in question occurs on a regulated market, or that the person dealing relies on a professional intermediary or is himself acting as a professional intermediary.'

Each of these elements is considered in turn. The legislation defines most of these terms in ss.54 through 60 of the CJA 1993, and therefore later sections of this chapter cross-refer with those definitions. Before turning to those questions of definition, however, we shall consider the two inchoate offences relating to insider dealing which are contained in s.52(2) of CJA 1993.

The two inchoate offences relating to insider dealing in s.52(2) of CJA 1993

Aside from the principal offence in s.52(1) of CJA 1993 considered immediately above, an individual with inside information may commit two further offences, as set out in s.52(2) of CJA 1993 in the following terms:

'(2) An individual who has information as an insider is also guilty of insider dealing if –

(a) he encourages another person to deal in securities that are (whether or not that other knows it) price-affected securities in relation to the information, knowing or having reasonable cause to believe that the dealing would take place in the circumstances mentioned in subsection (3); or

(b) he discloses the information, otherwise than in the property performance of the functions of his employment, office or profession, to another person.'

There are two offences here in effect. They are described as being "inchoate" in that they are offences of encouraging behaviour or disclosing information, and therefore operate in parallel to the principal offence.

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320 The term "person" may include companies as well as human beings; whereas "individual" can refer only to a human being.

321 See para

The first offence is committed if the insider encourages another person to deal in price-affected securities. Typically, this may involve an insider using a relative or a controlled person to deal in securities effectively on his behalf. The conditions in s.52(3) are that the securities be traded on a regulated market (as defined below) or that the insider relies on a professional intermediary or is himself a professional intermediary.[322]

The second offence is committed if the insider discloses the information to another person. However, this offence will not be committed if the disclosure takes place in the ordinary conduct of the insider's employment: for example if an insider communicates information to a fellow employee of the same company in the ordinary performance of her duties. Thus, for the insider to leave a Dictaphone cassette containing reference to the information for her secretary to type up as part of confidential minutes of board meeting would not fall within the offence; whereas for the insider to leave a Dictaphone cassette containing the information and instructions as to how to acquire shares in the company before the information becomes public knowledge would fall within the ambit of the offence, because the former use is in the ordinary course of the insider's employment whereas the latter would not be. On the terms of s.52(3)(b) the offence is committed simply by means of the disclosure. There is no requirement that the disclosure have been made with the intention of causing a dealing in securities. Instead the disclosure itself is sufficient to constitute the *actus reus* of the offence. Part V of the CJA 1993 is clearly intended to secure the orderly dissemination of information to the market generally, and not clandestine disclosure to associates, acquaintances or controlled persons.

Dealing in securities

The definition of "dealing in securities"

It is important to know what the expression "dealing in securities" encompasses. That term is defined in s.55 of the CJA 1993 in the following terms:

> '(1) For the purposes of this Part, a person deals in securities if –
>
> (a) he acquires or disposes of the securities (whether as principal or agent); or
>
> (b) he procures, directly or indirectly, an acquisition or disposal of the securities by any other person.

Significantly there is no restriction in the wording of the offence to circumstances in which the defendant must be acquiring or disposing of securities in the course of a business: therefore, this is not an offence directed solely at persons who are regulated by the FSA. Instead, the purpose of the offence is both to capture professional traders in the securities markets and also to capture infrequent, non-professional dealers in securities who are seeking perhaps to turn a quick, clandestine profit from a one-off opportunity because some inside information has come into their possession. Consequently, a person deals in securities not only as an experienced "dealer" but also as an inexpert (even first-time) participant in a securities transaction.

[322] Criminal Justice Act 1993, s.52(3).

Therefore, in s.55(1) an individual "deals" in securities whenever she either acquires or disposes of securities. Thus, the offence can be committed either by trying to lock in a profit on securities which are expected to decrease in value in the future by selling them before their market price falls, or by trying to acquire securities at a price which is lower than the level to which those securities are expected to rise in the future.

Acting as principal or as agent

An individual may commit the offence when acting either as principal or agent. Therefore, the individual does not have to be the principal who is dealing with the inside information: it would be enough if, for example, a Chief Executive Officer instructed a junior employee in the finance department to acquire securities on her behalf. What is required, however, for that junior employee to be "an individual" who commits the offence is that that junior employee must also have access to inside information and so satisfy the other elements of the offence. In this way, individuals who are used as dupes by an inside dealer may escape liability if they themselves had no inside information as to the performance of those securities. However, the question would need to be asked – in relation to the definition of "inside information"[323] – whether or not the Chief Executive Officer's instructions to acquire the securities were made in such a way or contained sufficient information that the junior employee thereby came into possession of inside information: if she did come into possession of such information then she would be an inside dealer herself. If the agent has no knowledge of the inside information, the principal remains liable as principal if she satisfies the remaining requirements of the offence.

Indirect dealings

The statutory draftspeople were alive to the possibility that the acquisition or disposal of securities might be arranged indirectly. Thus, if an insider, for example, used a wholly-owned "shell" company[324] to acquire securities on her own behalf then that would constitute "indirect" dealing in the securities.

There are a number of ways in which company or trust holding structures could otherwise be used to circumvent this legislation by suggesting that the insider was not performing the actions but rather that the company or the trustees were. Let us consider some property management structures. Suppose that, instead of being the sole shareholder in this shell company, the insider had settled the company's shares on trust so that the trustees held the shares and held the power to direct the company's activities: it is suggested that this would be no different from the preceding example if the insider is the sole trustee or de facto controls the decisions of the trustees.

The more difficult situation, it is suggested, might be that where the insider is one of a number of participants in an investment fund which deals in securities at a time when the insider held knowledge as to price-affected securities, whether as a beneficiary under a

[323] See para 26-24.
[324] Where the term a "shell company" refers to a company which does not trade and which exists solely as a vehicle to hold assets on behalf of the company's shareholders or ultimate individual owners (for example through a group structure).

trust or as a shareholder in an investment company. The reference in the previous sentence to the insider being “one of a number of participants”, it is suggested, is a reference to a number of potential situations, including the situation where the insider is only one of the trustees of the investment fund or the situation where the insider is one only of a number of investor-beneficiaries. It is suggested that it need not matter whether or not these parties acted at arm’s length from one another because the real mischief at which s.52(1) is directed is whether or not inside information has been misused. So, even if the investors had never met but if the insider had convinced the trustees to deal in the price-affected securities by telling them what she knew about the company in relation to which she had inside information, then the offence would have been committed. At that moment it is likely that the trustees may have become insiders too. Suppose the insider was an employee of the company. Even if the insider did not disclose the information involved but simply dropped her employee’s security pass for the company in question on the desk in front of the trustees and winked like a pantomime villain and implored them to do as she was suggesting, continuing to wink all the while, then the offence would have been committed, it is suggested, because the insider would have procured a misuse of the inside information even if she had no carried out the investment herself directly.

The test, it is suggested, should be whether or not it is the insider’s knowledge which is being used to drive the transaction forward. For example, is that knowledge the *sine qua non*[325] without which the transaction would not have taken place? Did the transaction only take effect because the participants were seeking to profit from the insider’s knowledge? Or is there some genuine proof that the trustees were intending to make that investment in any event for other demonstrable reasons in innocence of the inside information held by the insider and without relying on the insider’s advice. If so, then it is suggested that the insider – and any other participant who satisfied the requirements for the s.52(1) offence – should be taken to have committed that offence.

What constitutes acquisition and disposal of securities

The requirement of either acquisition or disposal of a security in the s.52(1) offence is not limited to the time at which a formal transfer of title is recorded in relation to that security with the appropriate registrar or by transfer of an instrument or certificate, as appropriate. Instead, the concepts of acquisition and disposal include, in effect, any transfer of an equitable interest by virtue of a contract to acquire or dispose of the security. Those concepts emerge from s.55(2) and (3) in the following terms:

> ‘(2) For the purposes of this Part, “acquire”, in relation to a security, includes –
> (a) agreeing to acquire the security; and
> (b) entering into a contract which creates the security.
> (3) For the purposes of this Part, “dispose”, in relation to a security, includes –
> (a) agreeing to dispose of the security; and
> (b) bringing to an end a contract which created the security.’

[325] “Sine qua non” means “the thing without which” the transaction would not have taken place. I.e. was knowledge of the inside information the only thing that prompted the insider to make the investment because the insider knew that she would be able to make a profit on that investment.

There is a transfer of an equitable interest in property when the absolute owner of the security enters into a specifically enforceable contract to transfer that security to its counterparty.[326] The rationale for the equitable interest passing is that once the contract is capable of specific performance then the counterparty is able to enforce the transfer of the security in equity; and because equity "looks upon as done that which ought to be done" equity will deem that the transfer of title takes effect automatically as soon as the contract is specifically enforceable: therefore, an equitable interest in the property passes, because equity is not able to pass the common law title.[327] Consequently, when a contract to transfer property between parties is created and specifically enforceable it is correct to think that equitable proprietary rights in that property will pass automatically between the parties. Therefore, an insider will have "dealt" with the securities as soon as such a contract for their transfer has been created. What is problematic in s.55(2)(a) and (3)(a) is the idea that it is sufficient for an acquisition or a disposal to have taken place once there is an "agreement" in place. It is suggested that "agreement" in this context should be read as a synonym for "specifically enforceable contract".

Activities through agents

The insider dealing provisions generally are not limited to activities undertaken solely by the insider and with her own hands: rather the insider dealing code extends more generally to activities performed by agents or trustees at the insider's behest. Thus s.55(4) and s.55(5) make provision as follows:

> '(4) For the purposes of subsection (1), a person procures an acquisition or disposal of a security if the security is acquired or disposed of by a person who is–
>
> (a) his agent;
> (b) his nominee; or
> (c) a person who is acting at his direction,
>
> in relation to the acquisition or disposal.
> (5) Subsection (4) is not exhaustive as to the circumstances in which one person may be regarded as procuring an acquisition or disposal of securities by another.'

An acquisition or disposal can be made through an agent. An agent will be a person acting on behalf of the insider. It is suggested that that agent need not be paid. A nominee, strictly defined, is a person who acts as trustee of a bare trust for the insider.

Derivatives to acquire securities

What is noticeable is that, on its face, the definition of "dealing in securities" in s.55 of CJA 1993 is very limited. The statute refers specifically to "dispose of the security" or "agreeing to acquire the security": in each case a reference to "the security", as opposed to the value which could be earned from a speculation derived from that security's market value. Since the enactment of the 1993 Act there has been a revolution in financial techniques whereby the economic equivalent of dealing in securities can be mimicked using derivatives such as cash-settled call options (whereby the buyer of that

[326] *Neville v Wilson* [1997] Ch. 144.
[327] Hudson, *Equity & Trusts*, 260.

option is able to acquire the cash flow which he would have received if he had acquired those shares on the stock market).[328] The way in which derivatives will be caught is under s.55(2)(b) and (3)(b) respectively whereby "entering into a contract to create a security" or "bringing an end to a contract which created the security" will constitute a "dealing" in that security. In this sense, Sch.2 includes in its definition of "security" any options or futures or contracts for differences. The use of derivatives in this context is explained in the next paragraph and thereafter the meanings of s.55(2)(b) and (3)(b) are considered.

There are two types of cash-settled option: call options and put options.[329] A cash-settled option pays the difference between the price which one party agrees to pay for the option and the market value of the underlying security at the time. No securities actually change hands: rather, this is a speculation on the profit which would have been made if the parties had actually acquired the underlying securities. So, an insider who wanted to "deal in price-affected securities" could acquire a cash-settled option which would pay her the profit which she would have earned had she actually acquired the securities and then sold them; alternatively she could acquire a cash-settled put option which would oblige the seller to pay her what she would have earned had the seller of the option been obliged to acquire the securities at their earlier, higher price. The insider could also use "physically-settled"[330] options in the same manner – either put or call – if she wanted to dispose of securities which she actually held at the time of creating the option. The option can also be structured so that the insider can exercise it at any time she chooses – either when the inside information is actually made public, or when she considers that "the heat has died down"[331] and no-one would notice her dealings. By effecting the option, however, the profit was locked in at a time when the information was price sensitive and therefore, it is suggested, that the mischief of the insider dealing code is directed would be satisfied.

As discussed above, s.55(2)(b) and (3)(b) CJA 1993 provide respectively that creating or bringing to an end an option or a future or a contract for differences will constitute a dealing in securities for the purposes of Part V.

Securities to which Part V applies

The scope of the securities to which Part V CJA 1993 applies is set out in Schedule 2 to that Act, by virtue of s.54 CJA 1993. The categories of securities which are covered in

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[328] Hudson, *Financial Derivatives*, para 2-44 *et seq*.
[329] These structures could use "forwards" as opposed to options, although the insider is more likely to use options because they do not compel him to go through with the transaction even if his guess is wrong and the price of the securities moves in another direction (as a forward would require), or if he gets cold feet and decides to renege on the insider dealings (as a forward would effectively require). Forwards compel the parties to buy or sell; whereas options give one party or the other the choice whether or not to exercise their rights.
[330] The concept of "*physical* settlement" is a derivatives market usage – it does not require that there are tangible securities, rather it denotes the fact that the parties intend to transfer title in securities (by registration or otherwise, as appropriate) rather than simply to speculate on underlying market movements without intending to transfer securities.
[331] Always assuming that the option was itself created during a prohibited period, even if its profits were only realised at some later date.

that Schedule are shares, debt securities, warrants, depositary receipts, options, futures, and contracts for differences.

Inside information

The definition of "inside information"

The concept of "inside information" is of central importance to insider dealing.[332] An offence will only be committed when a person has inside information which is used to deal in price-affected securities, as has been discussed already further to s.52(1) of CJA 1993. The consequence of that mismatch in knowledge is that the market is said to lose its integrity because it is rigged in favour of those insiders who are privy to such information.[333] This discussion, however, is concerned with the criminal law context of that expression. For the purposes of Part V, the term "inside information" is defined in s.56(1) CJA 1993 in the following manner:

> '(1) For the purposes of this section and section 57, "inside information" means information which –
>
> > (a) relates to particular securities or to a particular issuer of securities or to particular issuers of securities and not to securities generally or to issuers of securities generally;
> > (b) is specific and precise;
> > (c) has not been made public; and
> > (d) if it were made public would be likely to have significant effect on the price of any securities.

The effect of this subsection is that it provides a definition for the purposes of qualifying s.57 and the concept of an "insider", and it focuses the definition onto a narrow range of securities. The definition of "inside information" is thus very limited in scope. The information must comply with all four of the probanda in s.56(1): in short, it must be precise information relating to only one company. A large amount of confidential information relating to securities markets will, therefore, be excluded from the ambit of this particular offence. This provision is susceptible to a number of different interpretations.

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[332] The notion of "inside information" is also used in the Model Code in the UKLA Listing Rules and in relation to the regulation of market abuse.

[333] The argument is made by some intellectual property lawyers that permitting patent protection and copyright protection has the effect of enabling people to use their confidential information, which is kept privy from the rest of the marketplace, to earn themselves large profits. Those same lawyers then argue that the regulation of insider dealing is doing the opposite: preventing people from exploiting their inside information, when people with inside knowledge in the form of patents and so forth are encouraged to make profits. Therefore, it is argued, there are regulations to prevent insider dealing but not to prevent profits from inside knowledge. The answer to this conundrum of course lies in the perception of valid economic competition. It is necessary to encourage innovation than innovators are able to guard the fruits of their labours and the profits which will only flow from them if they are sufficiently well protected – although there are debates about how extensive those rights of protection should be and at what stage they restrict further innovation and competition. By contrast, insider dealing distorts access to capital markets and allows insiders to cause loss to others and generate undeserved profits for themselves. With insider dealing there is no correlative gain in the form of increased market innovation.

It is difficult to know how to interpret the expression requiring that the information "relates to particular securities". That could be taken either to mean securities of a particular type (e.g. all shares in the market), or to securities sharing a particular feature, or relating to companies of particular type or in a particular market sector, or it could mean only relating to securities of one company and of the same type (e.g. only ordinary shares, or only preference shares, or only bonds of the same denomination). Helping us to understand the intended scope of that expression is the next phrase in paragraph (a) which relates to "a particular issuer of securities", which would seem to limit the definition to securities of only one company, were it not for the following phrase in paragraph (a) which refers in the alternative "to particular issuers of securities", suggesting that there might be more than one issuing company. The final phrase of paragraph (a) tells us that the definition does not relate to "securities generally or to issuers of securities generally". Thus, we know it is not a reference to all issuers, but it may be a reference to more than one issuer where paragraph (a) provides "particular issuers of securities" as aforesaid.

So, we are somewhere between this provision applying to only one company at a time and it not applying to every issuing company. Where does one draw the line in between? It seems probable that the reference to "particular issuers of securities" in the plural was intended to cover information about a merger or takeover in negotiation between two issuing companies: in such a circumstance it would be sensible to cover information relating as it does to both of the parties to that mooted merger. However, beyond that example, it would be a difficult question to know when information relating to multiple issuers would be appropriate information to fall within the offence, given that information relating to the entire community of issuing companies is not. Might it be the case that information relating to a particular market sector would be suitable to make out the offence? If that information relates to a market sector (such as frozen concentrated orange juice) then that would seem to be too broad to be the sort of information which constitutes the mischief at which this section was aimed because a number of people are likely to know about information which relates to a specific market sector; unless it is information relating to a revolutionary patent about to be developed by one particular company, but then that would be information, in truth, relating to that particular company and not directly to the whole market sector. Alternatively, information about a change of heart in the defence ministry of the Ruritanian government so that it would not honour contracts with A plc and B plc would be information pertaining to a limited number of companies (albeit more than one company) which might be information falling within s.56(1) of the CJA 1993. However, beyond those comparatively straightforward examples, the precise meaning of this provision is unclear in the absence of clear authority.

The second requirement in the definition of "inside information" is that the information be "specific and precise".[334] Therefore, the information cannot relate to a general "nervousness" among management generally or "concerns" among many market analysts about market share; instead, the information would need to relate for example to the under-performance of a large, specific business unit before accounts are published, or knowledge of the imminent commencement of a class action law suit against a company. The precision required of the information colours the requirement of specificity in that it discounts general sentiment such as nervousness or optimism, and requires instead that the information relate to a particular feature of particular information

[334] The definition of "precise" information for the purposes of market abuse under s.118(C)(5) FSMA 2000 is considered below.

such accounting information or patents or litigation or some such activity which will have an effect on the value of securities but which will be known about only within an organisation before its publication. In Australia, the courts have required that the information should be "unequivocally expressed and discerned" and not require too much deduction on the part of its recipient.[335] The courts will tend to measure the significance of information by reference to whether or not its eventual publication did effect the market value of the securities.[336]

The third requirement in the definition of "inside information" is that the information "has not been made public". This is the principal test in practice. Once information is generally known in a marketplace then it loses its quality of being "*inside* information" because its possession is no longer limited to insiders. It is not made plain what would constitute the making public of information. Information may lie somewhere on a point between rumour and fact.[337] Clearly, once a *RIS* has transmitted the information as being fact, then it will cease to be inside information. What is more difficult to know is the effect of rumours in the market or speculative journalism: both of which would simply be a part of a rumour until they are confirmed as being fact. So, if the information was the subject of a speculative newspaper story – which was worded in terms of authorial speculation rather than reporting of historical fact – then it would be difficult to know whether the market sentiment as to the value of the securities (an upward movement for a positive rumour; a downward movement for a negative rumour) constitutes the publication of the aspect of the information which would affect the value of securities, in that a market rumour would already change the market valuation before a RIS carried the rumour as fact. If rumour were accepted as constituting publication, however, this might make matters too easy for an inside dealer to leak information so that it becomes a rumour before almost immediately dealing in the affected securities. If the insider timed matters correctly then she could claim that her dealing took effect after the rumour began to circulate; from a profiteering point of view, however, she would need to act sufficiently quickly so that she locked in her profit on the securities before the market began to react to the rumour and so deflated her profit bubble. Therefore, not accepting that rumours of this sort constitute publication makes it more difficult for a person who is contravening the spirit of the legislation to profit from that activity by relying on the intrinsically gossipy nature of real-time financial markets to mask her activities.

The fourth requirement is that the information must be of a kind which "if it were made public would be likely to have significant effect on the price of any securities". This requirement clearly excludes mere tittle-tattle about corporate affairs. The proof of this requirement in any given case will generally be proven one way or another when the eventual publication of the information hits the market: the price will either have moved or not moved significantly as a result. The concept of a *significant* movement in the price or value of securities will depend on habitual movements in the price of the security in question and the market on which it is traded. Insider dealing relates to activity on any regulated market - there are some markets which are much more liquid than others.

[335] *Ryan v Triguboff* [1976] 1 NSWLR 588, at 596, *per* Lee J; cited by B. Rider et al, *Market Abuse and Insider Dealing*, *op cit*., para. 3.36.
[336] *Chase Manhattan Equities Ltd v. Goodman* [1991] B.C.L.C. 897, at 931, *per* Knox J.
[337] In relation to takeovers, when a rumour about the possibility of a takeover is out in the marketplace, the regulator will usually require that some statement of some sort is made by the company. False information and false rumours in such situations will not constitute inside information: see *Charles Chan Sing-Chuk v Innovisions Ltd* [1992] 1 HKLR 254. See P. Wood, *op cit*., para 21-029.

Therefore, a liquid stock market might see large movements in the price of a share in any average business day, whereas an illiquid market might not expect the price of share to move significantly or very much at all except in exceptional circumstances. Therefore, a movement in the former type of market may need to be much larger than a movement in the latter market for it to constitute a "significant" movement. Similarly, a security with a high price may need to have a larger absolute movement in price to constitute that movement a significant, proportionate movement in price than a share with a smaller value. Thus a movement of fifty pence on a share worth £20 would be less dramatic than a movement of fifty pence on a share worth £2. Also, some securities will have a higher average turnover than other shares, and so an unusually large amount of activity in a fairly static security may add to the significance of the information. So, movements in the securities of companies trading in a new market sector – such as one driven by technology – may go through periods of volatile trading and so see the prices of securities move by large amounts regularly in many trading days, whereas other companies in more established markets might rarely see such movements except in times of general securities market turmoil.

The definition of "price-sensitive information"

It is not enough that the information be inside information of the sort described in s.56(2) of the CJA 1993, as considered immediately above, but rather it must also be "price sensitive information" relating to "price-affected securities". The definition of the term "price-affected securities" is set out in s.56(2) in the following terms:

> (2) For the purposes of this Part, securities are "price-affected securities" in relation to inside information, and inside information is "price sensitive information" in relation to securities, if and only if the information would, if made public, be likely to have a significant effect on the price of the securities.

Thus, as considered in the preceding paragraph,[338] the information must be information of a sort which would be "likely to have a significant effect on the price of the securities", where the term "significant" was considered in the previous paragraph. It is not required that there was in fact an effect on the price of the securities subsequently. Rather it is sufficient that it can be proven that this effect was "likely", even if it did not take effect, provided that it was information of a kind which could be anticipated to have this effect. Whether "likely" means that the significant effect on price must take effect "on the balance of probabilities" or be "almost certain" or simply be "more likely than not" is not entirely clear from the provision.

What manner of information relates to a particular issuer

The question arises what sorts of information can be said to "relate" to a particular issuer. Section 60(4) of the CJA 1993 provides that for the purposes of Part V of that Act "information shall be treated as relating to an issuer of securities which is a company not only where it about the company but also where it may affect the company's business prospects". Thus information can relate to a company, for the purposes of the insider dealing code, provided that it is "inside information" (as discussed already), even if it

[338] See para 26-29.

relates to the company's prospects and not simply to the company itself. It is not clear whether or not this could relate to market conditions affecting a number of companies, or whether it could relate to a factor which will affect a company's prospects indirectly (such as pending litigation or a creditor's petition for bankruptcy), or whether it should be limited to factors relating specifically to one issuer but affecting its prospects directly. It is suggested that a natural and literal reading of s.60(4) would encompass all three of these types of possibility.

A person having information as an insider

A person may have access to price-sensitive information or to information which, if commonly known, would have a significant effect on the value of securities, but that person may not necessarily have that information as an insider. So, a careful market analyst may have spotted a weakness in companies in a particular sector in relation to a particular external factor – such as interest rate movements, or the price of timber, or some such – and so may be able to speculate successfully on future price movements. However, that person is not an insider and that information would not be inside information if it was gleaned from public sources. The insider dealing code is only concerned to criminalise misuse of information by insiders. Therefore, it is important to know who will be an insider and in what circumstances they will be deemed to be acting as an insider. Section 57 of the CJA 1993 provides:

> (1) For the purposes of this Part, a person has information as an insider if and only if –
>
> (a) it is, and he knows that it is, inside information; and
>
> (b) he has it, and knows that he has it, from an inside source.

Therefore, there are two requirements here. Importantly, only these requirements will be sufficient. First, the insider must know that the information is inside information. The information must also be inside information as considered above in relation to s.56(1). The second requirement is that the insider knows that she has acquired the information from an "inside source". The test of knowledge which is appropriate in criminal law is that the insider must be subjectively aware that the information is inside information, as considered above.[339] This would mean that a new employee in the finance department of a company who filed away a draft press release with inside information on it, but who did not realise that this was information not yet generally known in the marketplace, and who then bought shares in the company on the strength of that information, would not have "known" that the information was inside information if he misunderstood the manner in which such information was released to the marketplace. The more difficult cases would revolve around employees who were insiders but who claimed to have no knowledge of the nature of the information but who might be considered to be disingenuous in their claims not to understand how such things worked. It is suggested that in practice these things are worked out only in the witness box. The question, in truth, is whether or not a judge or a jury (as appropriate) believes the defendant's claims not to have realised the nature of the information and the source of the information. Subjective tests of knowledge in the criminal law come down to the nature and experience of the individual defendant, and to their credibility in the witness box.

[339] See para 26-06.

The question as to what will constitute an “inside source” is set out in s.57(2) of the CJA 1993 in the following terms:

> ‘(2) For the purposes of subsection (1), a person has information from an inside source if and only if –
>
> (a) he has it through –
>
> (i) being a director, employee or shareholder of an issuer of securities; or
>
> (ii) having access to the information by virtue of his employment, office or profession; or
>
> (b) the direct or indirect source of his information is a person within paragraph (a).’

Therefore, inside sources will concern information which has come through a director of the issuer, of an employee of an issuer, or a shareholder of an issuer; or alternatively if that person herself receives the information from her employment or her office or her profession; or the information came directly or indirectly from such a person. Let us consider each element in turn.

The first type of inside source under s.57(2)(a) requires that the defendant “has it through” being one of three categories of person. Under s.57(2)(b) it can also constitute an “inside source” if a third party has the information through a person listed in s.57(2)(a), which is what makes this definition so interesting. The expression “has it through” is really quite broad. That would seem to encompass being told the information verbally or in writing by such a person; or over-hearing such a person talking; or intercepting that person’s written communications. The expression “has it through” does not require on its face that the insider communicated the information intentionally to the defendant. It would be within the literal sense of that expression that the defendant was a director’s gardener, for example, who overheard her talking to work colleagues on the telephone. Again, this approach would be appropriate if the mischief of the legislation was to prevent people taking advantage of information they come to know before it is made available to the public through a RIS or a newspaper or appropriate web-site. Thus, we have to ask whether a complete stranger who overheard an employee of an issuing company talking on a mobile phone in an otherwise empty train carriage, and who could identify the issuing company from the employee’s rucksack logo, would have had information through that employee if she bought the company’s shares as soon as she detrained: on a literal interpretation of s.57(2)(a) that person would have had information from an inside source.

The two types of insider on the case law

In *Attorney-General’s Reference (No.1 of 1988)*[340] Lord Lowry distinguished between “primary insiders” and “secondary insiders” on the basis of the 1985 Company Securities (Insider Dealing) Act. Primary insiders are directors, employees and shareholders, and any person who has information by virtue of his employment, office or profession, as set out variously in relation to s.57 CJA 1993. Secondary insiders are those people who acquire their information from primary insiders. This distinction may still be made on the offences considered above if one has a mind to do so, although, it is suggested, that the

[340] [1989] 1 A.C. 971.

development of the insider dealing legislation and the market abuse code have made this stark distinction less important than it might have been hitherto given the range of activities which now fall naturally within the statutory language, as considered already in this chapter.

Information "made public"

The focus of the insider dealing code is on preventing insiders from abusing information acquired from inside sources which is unknown to the investing public at large so as to earn personal profits and with the result of affecting the integrity of securities markets. In this regard s.58 of the CJA 1993 provides that:

> '(1) For the purposes of section 56, "made public", in relation to information, shall be construed in accordance with the following provisions of this section; but those provisions are not exhaustive as to the meaning of that expression.
> (2) Information is made public if –
> (a) it is published in accordance with the rules of a regulated market for the purpose of informing investors and their professional advisors;
> (b) it is contained in records which by virtue of any enactment are open to inspection by the public;
> (c) it can be readily acquired by those likely to deal in any securities-
> (i) to which the information relates; or
> (ii) of an issuer to which the information relates; or
> (d) it is derived from information which had been made public.'

Thus s.58(1) provides that the courts have leeway to develop the meaning of this expression beyond the terms of s.58(2). It is in s.58(2) that the core definitions are set out. Publication of information takes place in one of four contexts.

The first context depends upon publication in accordance with the ordinary rules of a regulated market[341] - it is suggested that publication in accordance with such rules should relate to regulated markets on which those securities are traded, as opposed to the hypothetical rules of some regulated market on which the securities are not traded, because otherwise the underlying purpose of ensuring integrity in securities markets will be thwarted.

The second context relates to "records" made available for inspection by the public. This would include published accounts and information as to directors' remuneration. The possibility for abuse here would be dealings in relation to securities where the information is hidden in voluminous records where it is unlikely to be found easily by members of the public.

The third context requires simply that the information can be "readily acquired" by those who are "likely to deal" in those securities or in relation to that information. This may include information published through a RIS but there is no reason in theory why it should not also be published only in an analyst's report if that report is ordinarily circulated among those who are likely to invest. That investors must be "likely" to invest suggests a small community of committed investors, as opposed to a larger community

[341] See para 16-09.

of less expert investors who may "possibly" invest: a literal reading of the focus on "likely" permits only the smaller community.

The fourth context is a general traverse which deals with information being derived from information which has been made public: thus including an understanding of an issuing company's financial position which would be derived from a close analysis of published accounting information.

This issue of the level of diligence which can be demanded of the recipient of information while still making information public is considered in detail in relation to s.58(3) in the following terms:

> '(3) Information may be treated as made public even though –
>
> (a) it can be acquired only by persons exercising diligence or expertise;
>
> (b) it is communicated to a section of the public and not to the public at large;
>
> (c) it can be acquired only by observation;
>
> (d) it is communicated only on payment of a fee;
>
> (e) it is published only outside the United Kingdom.'

Thus a number of possible objections to information being considered to have been made public are removed. As considered above in relation to the fourth context in s.58(2), for example, it is no objection that information has been cunningly concealed within accounting or similar information such that analysts would have to sift through those accounts before the information came clearly to light. This would of course give insiders a window between the publication of those accounts and the analysts' discovery of the truth in which securities could be dealt with on the basis that information had technically been published even though the market could be expected to take a while to discover what the insiders already know was hidden in the footnotes to the accounts. This would, of course, require a level of conspiracy but, after the amount of "creative accountancy" at play in the affairs of Enron, WorldCom and others, that cannot be discounted.[342]

The meaning of the term "issuer"

Section 60(2) of the CJA 1993 provides that for the purposes of Part V the term "issuer" in relation to any securities "means any company, public sector body or individual by which or by whom the securities have been or are to be issued".

Defences

The defence to the s.52(1) insider dealing offence

The defences to the s.52(1) insider dealing offence[343] are set out in s.53(1) CJA 1993. There are three alternative defences in s.53(1). Each is considered in turn.

[342] See

[343] See para 26-06.

First, that the defendant did not expect that the dealing would result in a profit. There are perhaps two ways of demonstrating this credibly: either by showing that the dealing was part of a larger transaction (perhaps to do with a hedging strategy[344]) and so not aimed at generating profit *per se*, or by showing that the dealing was not intended to make a profit of the magnitude it did because of the inside information but rather because of some other factor.

Secondly, that the defendant had reasonable grounds to believe that the information had been sufficiently widely disclosed. There is no statutory guidance on this concept. There is no guidance on the basis on which the defendant had this belief (mere disingenuousness (i.e. "surely everyone knew that?"), or having heard direct suggestions from a market participant, or having read the information herself in a newsstand publication) nor on how wide that dissemination should have been. Furthermore, the defence requires that "none of those taking part in the dealing would be prejudiced by not having the information".

Thirdly, the defendant must be able to prove that he would have acted as she had acted whether or not she had the information. This might be demonstrated by showing a pattern of speculative dealing in those securities, or by showing an investment strategy which demonstrated a credible role for those particular securities, or by showing that the investments were managed by an arm's length discretionary fund manager, or by showing that those securities formed part of a genuine hedging strategy.

The defence to the s.52(2)(a) encouragement to deal offence

The defence to the s.52(2)(a) encouragement to deal offence[345] is set out in s.53(2) CJA 1993. There are three alternative defences contained in this subsection. First, that the defendant did not anticipate that the dealing would result in a profit due to the price sensitive nature of the information. The same issues arise in relation to this defence as arose generally in relation to s.53(1)(a) above.[346] Secondly, that the defendant had reasonable grounds to believe that the information has been sufficiently widely disclosed. The same issues arise in relation to this defence as arose generally in relation to s.53(1)(b) above.[347] Thirdly, the defendant must be able to prove that he would have acted as he had acted whether or not he had the information. The same issues arise in relation to this defence as arose generally in relation to s.53(1)(c) above.[348]

The defence to the s.52(2)(b) disclosure of information offence

The defence to the s.52(2)(b) disclosure of information offence is set out in s.53(3) CJA 1993. There are two separate defences in this subsection. First, if the defendant can demonstrate that he did not anticipate that anyone would act on the disclosure by dealing on a regulated market or through a professional intermediary. Secondly, that

[344] Although a successful hedge would have to make a profit so as to balance out some loss made elsewhere.
[345] See para 26-06.
[346] See para 26-46.
[347] See para 26-46.
[348] See para 26-46.

even if the defendant did anticipate that there would be dealing but that he did not anticipate that those dealings would result in a profit attributable to the price sensitive nature of the information. This second defence raises similar issues to those considered above in relation to s.53(2)(a).

The special defences

Section 53(4) of the CJA 1993 provides that the special defences contained in Schedule 1 act in addition to the defences already considered. There are three classes of special defences relating to market makers, to market information, and to price stabilisation respectively. The first special defence relates to market makers[349] to the effect that[350] an individual is not guilty of insider dealing, by virtue of dealing in securities or encouraging another person to deal, if she shows that she acted in good faith either in the course of her business as a market maker or in the course of employing a market maker.

The second special defence relates to individuals who deal in securities using inside information if she can demonstrate that that information was "market information",[351] and that "it was reasonable for an individual in his position to have acted as he did despite having that information as an insider at the time".[352] In this context, "market information" relates to a series of facts which are known about those securities:[353] that securities of a given kind are to be dealt in or that dealings are under negotiation, including the number of securities which are to be dealt in; or that the price at which securities are to be dealt in is under negotiation; and finally, the identity of the people who are likely to be involved in securities dealings. It is provided that what is "reasonable" depends upon the content of the information, the circumstances in which the information was acquired by the insider, and the capacity in which the insider was acting.[354] This paragraph does not help us to know what "reasonable" actually means, although it does tell us some of what we would need to take into account in considering whether or not a given defendant had acted reasonably. Clearly, if an insider was dealing with the information in the course of an employment then that would be reasonable. If the defendant was employed by a RIS and preparing the information for publication then that would be reasonable.

There are two further specific defences. The offences in s.52 of the CJA 1993 do not apply to 'anything done by an individual acting on behalf of a public sector body in pursuit of monetary policies … with respect to exchange rates or the management of public debt or foreign exchange reserves'.[355] Similarly an individual is not guilty of insider dealing if she was acting in conformity with price stabilisation rules under s.144(1) of the FSMA 2000.

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[349] '(2) A market maker is a person who (a) holds himself out at all normal times in compliance with the rules of a regulated market or an approved organisation[349] as willing to acquire or dispose of securities; and (b) is recognised as doing so under those rules.'

[350] Criminal Justice Act 1993, Sch.1, para.1.

[351] Criminal Justice Act 1993, Sch.1, para.2(1)(a).

[352] Criminal Justice Act 1993, Sch.1, para.2(1)(b).

[353] Criminal Justice Act 1993, Sch.1, para.4.

[354] The term "reasonable" in art 2(1) is susceptible of many interpretations. If we were of a cynical cast of mind – like the philosopher Hume – we might consider it reasonable for a man in possession of valuable information to make a profit from it as soon as possible. However, in the context of securities regulation we must assume that such largesse is not the legislative intention.

[355] Criminal Justice Act 1993, s.63(1).

The private law enforceability of contracts

Even if an offence has been committed that does not necessarily invalidate any contract which has been created as part of its commission. Thus, s.63(2) of the CJA 1993 provides that: 'No contract shall be void or unenforceable by reason only of section 52'. Consequently the contract may still give rise to all of the remedies available under contract law and will not permit a defendant to escape liability by claiming that the contract is void *ab initio* through its illegality.

THE RATIONALE FOR THE OFFENCES OF INSIDER DEALING

Why criminalise insider dealing?

There is some debate among the commentators as to why insider dealing has been criminalised at all. There are two broad schools of thought on insider dealing. One school of thought considers that insider dealing is a victimless crime and comparatively rare, and therefore not worthy of criminalisation. The second school of thought considers insider dealing to be a cancer in the heart of our securities markets and a demonstration of a lack of market integrity.

The principal reasons for criminalisation are that if insider dealing is permitted then investors will not have confidence in the integrity of the market: that is, if insiders are permitted to take profits from their investments on the basis of the manipulation of information which is unknown to other investors, such that the insider can be confident that that information will drive the market price of that security either up or down significantly, then inside investors are able to earn profits from the lack of knowledge of outsiders. There is an ethical problem here in that some investors will be able to exploit the ignorance of other investors when those other investors could not possibly have known better: after all, for the insider to generate a profit, it is necessary that there are unwitting investors buying at the price before the information becomes public knowledge and after the information has become public knowledge, such that the unwitting investors were buying at prices which could only benefit the insiders. There is also an economic problem here. If some investors were allowed to take profits in circumstances in which they are manipulating the lack of knowledge of other investors then those other investors are likely to stop investing in securities markets because they will consider that those markets are rigged in favour of insiders. Consequently, there will be a drying-up of liquidity for companies and other bodies wishing to access capital markets by issuing securities because the number of investors will have greatly reduced. The goal of the EU in particular is to promote deep, liquid capital markets: that requires as many investors as possible to feel confident in investing in those markets.

The first school of thought considers that no-one loses anything from insider dealing. Rather, it is said, some of the sharper market participants simply make a well-earned profit due to their shrewd knowledge of the markets and of the people in them. It is said that having inside information is just like having some intellectual property, like a patent or a copyright: you have access to an idea or to knowledge to which other people do not have access, and that idea or knowledge can make you money.[356] Thus it is said that

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[356] See, for example, T. Boyle, *Shamen, software and spleens*.

having some inside information to which no-one else has access is akin to having a patent: that is, an ability to make a profit which no-one else has. So, it is said, if you can take advantage of your copyright while the law prevents other people from taking similar advantage of that copyright, then why should possessors of knowledge about markets be criminalised if they turn a similar profit?

The second school of thought suggests, however, that we should observe that there is a distinction between intellectual property and insider dealing: copyrights and patents are the fruits of someone's labours and are necessary to ensure that that person and that person alone is able to benefit from their labours for an identified period, and in part acts as an encouragement to them and to other people to persist with their economically valuable labours with the promise of the protection of intellectual property law. By contrast, insider dealing lacks the quality of compensating honest, entrepreneurial toil because the inside dealer has not developed any economically valuable product or idea. Furthermore, encouragement of insider dealing activity will simply skew capital markets in favour of those insiders who have access to this sort of information at a time when economic expansion in the EU as a whole relies on capital markets to fund and support economic growth. It is feared that this will dissuade a large number of investors from investing in capital markets because they cannot know that the market is being operated honestly, nor that the price they will pay for securities reflect their genuine worth.[357]

Capital markets become skewed, it is suggested, precisely because two tiers of investors are created – one with the information and one without the information – such that one is able to take advantage of the other with the result that in the future the second tier of investors will be reluctant to participate in that capital market. It is a long-term risk to the securities markets that liquidity will thus be reduced, and not a short-term risk confined to any one transaction. It is not just that a particular issue of securities today will be skewed but rather that a number of investors will withdraw from the market permanently because they will have no confidence in it and so that they will withdraw their capital from future deals. That is why one talks of market integrity more than just fairness between any two contracting parties buying and selling securities.

However, there is also a problem of fairness between contracting parties. No-one doubts that insider dealing constitutes sharp practice, because one party is able knowingly to take advantage of the ignorance of the other as to the likely future performance of that security once the inside information is publicly known: all that differs is whether one thinks that life is to the swift and therefore that taking the benefits of such sharp practice is no matter, or whether one thinks that there is an ethic essential to properly functioning markets which means that one cannot hoodwink counterparties but rather that one can only take advantage of their ignorance if one is relying solely on one's own skill. It is a little like taking performance enhancing drugs in athletics. If one takes the drugs then one is likely to outperform a similar athlete who has not taken them, but the ethic involved suggests that that race was unfairly organised if one athlete was always more

[357] That is, if insiders know of information which will enable them to make profits in the future, then that must necessarily mean that the current market price does not the price which the market place as a whole will pay for those securities because the insiders know (or expect with some confidence) that the market price will change sufficiently in the future (when the information becomes public) so as to make those insiders a profit. In this sense, those market values are not genuine prices because the insiders know that those prices will change in such a way that they will earn profits which are not transparent to the rest of the market.

likely to win otherwise than due to their skills or their dedication and so forth. A clean athlete deserves her success, whereas the doped athlete does not. It is this species of ethical argument which distinguishes the acceptability of a well-resourced, skilful and dedicated investment firm relying on their superior analysts to make excellent predictions about market movements and so to make money from counterparties, from the unacceptability of someone exploiting an unfair advantage acquired through misuse of inside information to make a profit from dealing with counterparties before the market has had time to react to the information or even to know about the information. The former dealer deserves their profit whereas the latter does not. The latter has simply cheated. And a market which is known both to favour cheats and to be peopled by large numbers of cheats will not attract the volume of investors and their funds that it would otherwise do.

The prevalence of insider dealing in some contexts

The former Chief Executive of the FSA, John Tiner, at the time he stepped down from that post, published FSA research into the large volume of suspicious trading activity which had taken place in particular before announcements about takeovers.[358] It was his assertion that insider dealing occurs frequently, but that it is difficult to prove. Not uncommonly there are difficult-to-explain clusters of speculation around one particular security over a short space of time (often a large amount of activity within minutes) without any public disclosure of information which tends to suggestion collusion among inside dealers but which is very difficult to prove constitutes insider dealing beyond a reasonable doubt. The use of complex derivative transactions and intermediaries to hide the true controlling minds of the dealing operations, as considered in the examples given above,[359] make it difficult for regulators to be able to identify with certainty any insider dealing: i.e. if Z has lined up a series of put options which permit Z to sell shares in Target plc at a given price, then it is easy for Z to sell those shares very quickly off-exchange. Unlike the Securities and Exchange Commission in the USA, the FSA does not have the power to offer immunity from prosecution to whistleblowers and so the job of identifying insider dealers and proving the mens rea of one of the offences is made all the harder. The FSA is seeking to deal more strictly with regulated firms' procedures relating to market abuse to ensure that leaks of inside information are less likely. There were similar reports in the financial press some months earlier that the FSA had found suspicious patterns of trading in relation to a large number of large takeover transactions. Whereas some suggest that insider dealing is not so great a problem as is sometimes suggested,[360] what emerges from this research is that insider dealing and market abuse remain significant problems which do challenge the integrity of our securities markets.

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[358] *The Financial Times*, 3 July 2007.
[359] See para 26-13.
[360] See, e.g. B. Rider and M. Ashe, *Insider Crime* (Jordans Publishing, 1993), 1-7; B. Rider, K. Alexander and L. Linklater, *Market Abuse and Insider Dealing* (Tottel Publishing, 2002), 93 *et seq.*; P. Wood, *Regulation of International Finance* (Sweet & Maxwell, 2007), 534 *et seq*.

The offence of making misleading statements

Manipulating financial markets

The notion of criminalising activity which intentionally seeks to pervert or manipulate markets is not new to English criminal law. Thus, the spreading of rumours calculated to cause movements in the price of goods or securities has long been criminalised as a species of fraud.[361] The offences relating to market manipulation in this context, however, relate specifically to the offences created in s.397 of the FSMA 2000. The activities which constitute these offences involve activities such as publishing false prices, or dealing in large volumes to drive prices especially just before to the close of trading,[362] or seeking to monopolise a market. There are also new offences relating to fraud enacted in the Fraud Act 2006 which is considered in Chapter [15].

The activity which will give rise to the offence

The offence of making misleading statements is set out in s.397(1) of the FSMA 2000 and then the description of the offence is set out in s.397(2) of the FSMA 2000. Section 397(1) provides as follows:[363]

> '(1) This subsection applies to a person who –
>
> (a) makes a statement, promise or forecast which he knows to be misleading, false or deceptive in a material particular;
>
> (b) dishonestly conceals any material facts whether in connection with a statement, promise or forecast made by him or otherwise; or
>
> (c) recklessly makes (dishonestly or otherwise) a statement, promise or forecast which is misleading, false or deceptive in a material particular.'

The activities which will make out the offence of making misleading statements contained in s.397(1) of the FSMA 2000[364] is committed in one of three circumstances. First, where a person makes a statement, promise or forecast which "he knows to be misleading, false or deceptive in a material particular".[365] What is not made clear in this context is what will constitute knowledge; that is, whether one can be taken to "know" a

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[361] Among the common law offences applicable here are conspiracy to defraud: *R v De Berenger* (1814) 105 E.R. 536 (where false rumours about Napoleon's death were spread with a view to increasing the price of bonds artificially), and *Scott v Brown* [1892] 2 Q.B. 724 (where a conspiracy was hatched to make it appear that there was a market for shares whereby one of the conspirators bought shares on the exchange at a high price). There was an overlap between monopolisation and market manipulation in relation to the law on fraudulent misrepresentation: see *Salaman v Warner* (1891) 65 LT 132, 7 TLR 454; *Sanderson & Levi v British Mercantile Marine & Share Co*, *The Times* 19 July 1899: cited in P. Wood, *op cit.*, para 20-010.

[362] See, for example, *R v Securities and Futures Authority Ltd, ex p. Fleurose* [2001] EWHC Admin 292, where the defendant engaged in large numbers of transactions eight minutes before the close of trading to move the price in a security which would otherwise have required the defendant to lose money on another transaction. The investment firm was fined and the individual trader involved was suspended. See P. Wood, *op cit.*, para 20-014.

[363] Cf. *R v. De Berenger* (1814) 3 M. & S. 66.

[364] Cf *R v De Berenger* (1814) 3 M & S 66.

[365] Financial Services and Markets Act 2000, s 397(1)(a).

statement is misleading only if you have actual knowledge, or whether it would be sufficient to have constructive notice of its misleading nature, or whether it would be sufficient that one has wilfully and recklessly failed to made the inquiries which an honest and reasonable person would have made in that context.[366]

Second, where such a person "dishonestly conceals any material facts" in relation to a statement, promise or forecast.[367] Again, it is unclear whether dishonesty in this context would require actual fraud or whether it could be established in circumstances in which the defendant fails to act as an honest person would have acted in the circumstances.[368] It is suggested that the latter would accord most closely with the "reasonable user" test within the market abuse code more generally: that is, the FSMA 2000 and the *FSA Handbook* are concerned to establish objective standards against which the behaviour of market participants should be measured and therefore it would be in keeping with the rest if the Act to consider a defendant's culpability from an objective standpoint. However, the approach of the criminal law generally is to require that the defendant personally have realised that his actions were dishonest.[369]

The third context is that in which such a person "recklessly makes (dishonestly or otherwise) a statement, promise or forecast which is misleading, false or deceptive in a material particular".[370] Recklessness in criminal law requires that the defendant was aware of the harm which would result from the act but that he nevertheless acted so as to cause that harm.[371] The statute falls to be analysed on a case-by-case basis, it is suggested, and the debate is the same as that in relation to dishonesty and knowledge above: is it sufficient that a reasonable person would have appreciated that there was a risk of harm or must the defendant subjectively have appreciated that there was a risk of harm in the context? As above, it is suggested that the choice is between the underlying purpose of the FSMA 2000 to create objective standards against which the behaviour of market participants can be measured, and the ordinary approach of the criminal law which is to require that the defendant had some subjective appreciation of the circumstances as part of his *mens rea*. Thus, circulating an analyst's forecast (if, it is suggested, the view presented in that forecast is not genuinely meant) with a view to manipulating the market by dint of driving the investment decisions of those who received the report, would constitute market manipulation, but not if there was no intention to manipulate the market.[372]

The further requirement of inducing behaviour in the representee

As is provided in s.397(2) of the FSMA 2000, the offence predicated on the behaviour set out in s.397(1) is made out in the following circumstances:

> '(2) A person to whom subsection (1) applies is guilty of an offence if he makes the statement, promise or forecast or conceals the facts for the purpose of

[366] Eg *Re Montagu* [1987] Ch 264.
[367] Financial Services and Markets Act 2000, s 397(1)(b).
[368] Eg *Royal Brunei Airlines v Tan* [1995] 2 AC 378.
[369] *R v Ghosh* [1982] QB 1053, [1982] 2 All ER 689.
[370] Financial Services and Markets Act 2000, s.397(1)(c).
[371] *R v G* [2004] 1 AC 1034; *Brown v The Queen* [2005] 2 WLR 1558.
[372] See, for example, the reference to *Casoni* in P.Wood, *op cit.*, para 20-25.

inducing, or is reckless as to whether it may induce, another person (whether or not the person to whom the statement, promise or forecast is made)-

> (a) to enter or offer to enter into, or to refrain from entering or offering to enter into, a relevant agreement; or
>
> (b) to exercise, or refrain from exercising, any rights conferred by a relevant investment.'

Therefore, the defendant commits the offence if he intends to induce or is reckless as to whether or not it would induce another person to behave accordingly by means of entering into an agreement or by means of not entering into an agreement or exercising right (such as rights under an option).

The statutory defence

There is a defence provided for a person who would otherwise have committed the offence in s.397(2) as a result of making "a statement, promise or forecast which he knows to be misleading, false or deceptive in a material particular"[373] by way of s.397(4) of the FSMA 2000 in the following three scenarios:

> '(4) In proceedings for an offence under subsection (2) brought against a person to whom subsection (1) applies as a result of paragraph (a) of that subsection, it is a defence for him to show that the statement, promise or forecast was made in conformity with –
>
> (a) price stabilising rules;
>
> (b) control of information rules; or
>
> (c) the relevant provisions of Commission Regulation (EC) No 2273/2003 of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programmes and stabilisation of financial instruments.

The defence is therefore made out when the defendant is complying with rules relating to price stabilisation or control of information.

The offence of creating a false or misleading impression as to the market

The components of the offence

The offence of creating a false or misleading impression as to the market is set out in s.397(3) of the FSMA 2000 in the following terms:

> (3) Any person who does any act or engages in any course of conduct which creates a false or misleading impression as to the market in or the price or value of any relevant investments is guilty of an offence if he does so for the purpose of creating that impression and of thereby inducing another person to acquire, dispose of, subscribe for or underwrite those investments or to refrain from doing so or to exercise, or refrain from exercising, any rights conferred by those investments.

[373] As provided in Financial Services and Markets Act 2000, s.397(1)(a).

Thus the creation of a false or misleading impression as to the market, with a view to encouraging some other person to acquire an investment or to refrain from exercising some other right, will constitute an offence. It is not required that the seller be dishonest: simply that that the false or misleading impression be created and that it be done "for the purpose of … inducing" a person to act in a way set out in the subsection. There must, it seems, be an intention that the buyer be induced to act as they do, but nothing more than that. It is a defence that the defendant "reasonably believed" that his actions would not create a false nor a misleading impression.[374] It is also a defence for the defendant to show that he acted as he did to stabilize investment prices[375] or in conformity with "control of information rules".[376]

The statutory defence

There is a statutory defence in s.397(5) of the FSMA 2000 to the offence of creating a false or misleading impression in the following terms:

> (5) In proceedings brought against any person for an offence under subsection (3) it is a defence for him to show –
>
> > (a) that he reasonably believed that his act or conduct would not create an impression that was false or misleading as to the matters mentioned in that subsection;
> >
> > (b) that he acted or engaged in the conduct –
> >
> > > (i) for the purpose of stabilising the price of investments; and
> > >
> > > (ii) in conformity with price stabilising rules; …
> >
> > (c) that he acted or engaged in the conduct in conformity with control of information rules; or
> >
> > (d) that he acted or engaged in the conduct in conformity with the relevant provisions of Commission Regulation (EC) No 2273/2003 of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programmes and stabilisation of financial instruments.

There are two forms of defence here, it is suggested. The second form of defence mirrors the statutory defence under s.397(4) relating to compliance with price stabilisation and control of information rules. The first form of defence is unique to this particular offence. This defence, in paragraph (a), requires reasonable belief that he was not creating a false nor a misleading impression.

MARKET ABUSE REGULATION

The FSA regulation of market abuse is concerned with the imposition of civil penalties, as opposed to criminal offences. The principles considered in this chapter are drawn from the EC Market Abuse Directive as implemented by Part 8 of the Financial Services

374 Financial Services and Markets Act 2000, s.397(5)(a).
375 Financial Services and Markets Act 2000, s.397(5)(b).
376 Financial Services and Markets Act 2000, s.397(5)(c).

and Markets Act 2000 ("FSMA 2000"), and the FSA Market Abuse Rulebook ("MAR") focusing particularly on the Code on Market Conduct (referred to as "MAR 1") which is found in Chapter 1 of MAR. The principal focus of this chapter is on the market abuse principles of the FSMA 2000 as supplemented by MAR 1.

The regulation of market abuse is concerned to maintain the integrity of the securities markets. Without a perception of market integrity among the potential investor base for the securities markets there may not be sufficient capital available to fuel economic growth in the EU. The particular mischief at which FSA market abuse regulation is aimed is the misuse of "inside information" in relation to companies whose securities are in issue. Access to inside information gives its holder an unfair advantage in the securities markets. In the criminal law context this is a concern with insider dealing, but insider dealing prosecutions have been few and far between such that it was considered necessary to empower national regulators to oversee market abuse too. The principles on which this regulation is based are set out in the Market Abuse Directive.[377]

The Market Abuse Directive

The policy underpinning the directive

The Market Abuse Directive[378] deals with "insider dealing and market manipulation" and is concerned with the preservation of "market integrity". The opening to the preamble to the directive considers that market integrity is necessary for an "integrated and efficient financial market" which in turn is considered to be necessary for "economic growth and job creation" in the EU.[379] The recitals to the directive further provide that "market abuse harms the integrity of financial markets and public confidence in securities and derivatives".[380] The economic objective underpinning the directive is the need to develop a pan-European securities market to provide a pool of liquid investment capital. To develop a pool of liquid capital, however, requires the confidence of a concomitant pool of investors. Maintaining investor confidence requires, *inter alia*, market integrity and therefore requires control of market abuse. There is therefore an ethical dimension to the preservation of market integrity which is subordinate, in the terms of the directive, to its economic goals: whatever harms market integrity harms the productivity of the European capital markets, which in turn harms the real economy.

This policy is different from that which underpinned the criminal code on insider dealing in Part V of the Criminal Justice Act 1993: that legislation was concerned to prevent one party to a transaction from having unfair access to information which the other party does not have. This is an explicitly ethical element which is less apparent in the MAD. On one view this might be said to come to the same thing: preventing manipulation of the market has a macroeconomic effect when applied to all transactions on the securities markets and it also has a microeconomic effect from transaction to transaction by preventing one party to a transaction from taking advantage of the other party by the misuse of "inside information".

[377] 2003/6/EC.
[378] 2003/6/EC.
[379] Market Abuse Directive, 2003/6/EC, ("MAD"), Recital, (1).
[380] MAD, Recital, (2).

"Inside information"

The reference in MAD to "inside information" is a reference to

> "information of a precise nature which has not been made public, relating, directly or indirectly, to one or more issuers of financial instruments or to one or more financial instruments and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments".[381]

There are other matters which member states are required to prohibit: the disclosure of inside information to another person;[382] recommending that a person deal in securities on the basis of the inside information;[383] inducing a person deal in securities on the basis of the inside information;[384] and making sure that all of the foregoing prohibitions apply to any person in possession of the inside information who should have been aware that it was inside information.[385]

"Market manipulation"

Market manipulation is a process by which a person, or a group of people, try to inflate or to depress the market value of securities by dealing in them in concert and possibly while circulating rumours as to the prospects for those securities. Member states are required to prohibit "any person from engaging in market manipulation".[386] The reference in the directive to "market manipulation" is a reference to:[387]

> "(a) transactions or orders to trade:
>
> - which give, or are likely to give, false or misleading signals as to the supply of, demand for or price of financial instruments; or
> - which secure, by a person, or persons acting in collaboration, the price of one or several financial instruments at an abnormal or artificial level,
>
> unless the person who entered into the transactions or issued the order to trade establishes that his reasons for so doing are legitimate and that these transactions or order to trade conform to accepted market practices on the regulated market concerned;
>
> (b) transactions or orders to trade which employ fictitious devices or any other form of deception or contrivance;
>
> (c) dissemination of information through the media, including the Internet, or by any other means, which gives, or is likely to give, false or misleading signals as to financial instruments, including the dissemination of rumours and false or

[381] MAD, art. 1(1).
[382] MAD, art. 3(1).
[383] MAD, art. 3(2).
[384] MAD, art. 3(2).
[385] MAD, art. 4.
[386] MAD, art. 5.
[387] MAD, art. 1(2).

misleading news, where the person who made the dissemination knew, or ought to have known, that the information was false or misleading. In respect of journalists when they act in the professional capacity such dissemination of information is to be assessed […] taking into account the rules governing their profession, unless those persons derive, directly or indirectly, an advantage or profits from the dissemination of the information in question.'

The concern here is with distorting a market in several ways. The simplest means of manipulation would arise by giving out incorrect or misleading information, in effect, so as to encourage investors to deal in a way in which, or at a price at which, they would not otherwise have dealt had they known the true position. Another means of manipulating a market would be to enter into a number of transactions so as to make it appear that there is a market for a security at a price at which there would not have been such a market but for those transactions. Yet another means of manipulating the market is to disseminate rumours or misleading stories which would affect the value of securities. The reference to "accepted market practices" is defined in the directive to mean "practices that are reasonably expected in one or more financial markets and are accepted by the competent authority in accordance with guidelines adopted by the Commission in accordance with the procedure laid down in article 17(2)".[388]

The nature of the civil market abuse code

The market abuse provisions in Part 8 of FSMA 2000 (sections 118 through 131A, hereafter referred to as "the market abuse code") create a code of rules which empowers the FSA to impose penalties on people who deal on the basis of inside information in the manner described in s.118 *et seq.* of the FSMA 2000.[389] Strictly speaking these rules are not part of the criminal law but rather grant powers to the FSA to impose penalties, as considered immediately below. The market abuse regime relates to "qualifying investments" traded on the London Stock Exchange and other prescribed markets[390] where the behaviour falls into one of the seven categories of behaviour set out in s.118(1) of the FSMA 2000, as considered below.

The market abuse code is not a code which creates criminal offences, although the proper jurisprudential categorisation of the right of a public body to impose penalties is an interesting question, in that giving a public body like the FSA the power to impose penalties does seem to create a quasi-criminal jurisdiction for that public body. The aim of the market abuse regime is to expand the powers of the FSA to deal with those market participants – whether authorised or unauthorised under the legislation – who act inappropriately but nevertheless outside the ambit of the ordinary criminal law for misfeasance in financial dealings. The importance of this regime is that it carries punitive penalties but that it does not replicate all of the protections and rights which are characteristic of the criminal law; this in itself may cause difficulties in relation to art 6 of the European Convention of Human Rights and its guarantees of a right to a fair trial.

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[388] MAD, art. 1(5).
[389] See para .
[390] Financial Services and Markets Act 2000, s.118(1).

The scope of the market abuse provisions

The provisions of the Market Abuse Directive and the FSMA 2000 market abuse code are concerned with abuses of inside information and are also concerned with preventing an insider from allowing herself to be put in a situation in which there could be a suspicion that they have misused "inside information".[391] The use of inside information will constitute market abuse for the purposes of the FSMA 2000. Section 118 of the FSMA 2000, as amended to give effect to MAD, provides that:

> '(1) For the purposes of this Act, market abuse is behaviour (whether by one person alone or by two or more persons jointly or in concert) which -
>
> (a) occurs in relation to –
>
> (i) qualifying investments admitted to trading on a prescribed market,
>
> (ii) qualifying investments in respect of which a request for admission to trading on such a market has been made, or
>
> (iii) in the case of subsection (2) or (3) behaviour, investments which are related investments in relation to such qualifying investments, and
>
> (b) falls within any one or more of the types of behaviour set out in subsection (2) to (8).'

There are therefore seven types of behaviour which will constitute market abuse. Market abuse can be committed by an individual or by a legal person or by more than one person acting "jointly or in concert". The reference to "joint action" would encompass any action performed by two people together or in a way which made them joint tenants or tenants in common of property. Acting "in concert" would not require that they acted together in this manner but rather would require simply that they had undertaken some coordinated plan of action or otherwise acted in a manner which constituted a form of conspiracy between them. The term "qualifying investment" is not defined in Part 8 of the FSMA 2000, although the term "investment" is defined by reference to s.22 of FSMA 2000 and Sch.2 to that Act, which define the financial instruments which constitute regulated activities for the purposes of the Act. The various forms of behaviour are considered in turn below.

The types of behaviour constituting market abuse

The types of market abuse as divined from FSMA 2000 and the FSA Market Abuse Rulebook, MAR 1

As provided in s.118(1)(b) of the FSMA 2000, behaviour constituting market abuse is any one or more of the seven following forms of behaviour. In relation to the various forms of behaviour, the term "behaviour" itself constitutes either action or inaction.[392] Thus a person may commit market abuse either by acting or by omitting to act. The term "inside information" is considered below,[393] as is the term "insider".[394] The FSA then sets

[391] Listing Rules, Chap. 9, Annex 1R.
[392] Financial Services and Markets Act 2000, s.130A(3)
[393] See para .
[394] See para .

out its Code on Market Conduct in chapter 1 of the Market Abuse Rulebook (known as "MAR 1") which fleshes out the various types of market abuse. The following parts of this section of this chapter knit together the types of market abuse provided for in s.118 of the FSMA 2000 with the provisions of MAR 1 so as to generate a comprehensive picture of what will constitute market abuse in regulatory terms in the UK.

(1) Dealing in a qualifying investment: "insider dealing"

The first type of behaviour is akin to insider dealing, as s.118(2) of the FSMA 2000 sets out in the following terms:

> 'The first type of behaviour is where an insider deals, or attempts to deal, in a qualifying investment or related investment on the basis of inside information relating to the investment in question.'

The principal distinction from the criminal offence of insider dealing in s.52(1) of the CJA 1993 is that the investments in question here do not need to be "price-affected securities" in relation to the information. This behaviour constitutes market abuse when there is a dealing in securities or an attempt to deal in securities, thus if the counterparty refuses to perform the transaction due to a suspicion about the information involved or if the transaction is otherwise not completed then behaviour constituting market abuse will still have been committed. The information at issue must be inside information as defined for these purposes below.[395]

The FSA gives examples of behaviour which it considers would fall within this head of behaviour in "MAR 1". Quite simply, in the first place, "dealing on the basis of inside information which is not trading information" constitutes market abuse.[396] In this sense, "trading information" should be taken to be information akin to market rumour which is not inside information because it is not restricted to insiders and it is not the sort of analytical information on which all competent, reasonable traders could be expected to act in any event.

There are three further examples of market abuse. First, 'front-running' whereby a person deals in securities in advance of the publication of the information by taking advantage of the "anticipated impact" of the order on the market price.[397] Secondly, in relation to takeovers, an offeror or potential offeror takes a position which provides "a merely economic exposure to movements in the price of the target company's shares", such as taking a spread bet on that share price or acquiring a cash-settled put option on those shares.[398] Thirdly, in relation to takeovers, a person acting for the offeror or a potential offeror deals on his own account in relation to the target company's shares.[399] Generally speaking, the FSA will not consider a deal to be market abuse if the deal took place before the dealer had the information, or if the dealer was satisfying some pre-existing legal obligation (such as a contractual obligation to supply those shares to a client under a physically-settled option), or in relation to a corporate dealer if the

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[395] See para .
[396] MAR, 1.3.2(1)E.
[397] MAR, 1.3.2(2)E.
[398] MAR, 1.3.2(3)E.
[399] MAR, 1.3.2(4)E.

particular employees involved did not know the information at the time of dealing.[400] There are other examples of insider dealing given in MAR in relation to the use of information in relation to commodities transactions.[401]

The acid test, it is suggested, based on FSA guidance, is that if the inside information is either the reason for the dealing in securities or is a material influence on that dealing, then it will be presumed to be a dealing made on the basis of inside information, and so market abuse.[402] By contrast, retaining the information behind an effective and properly constructed Chinese wall will suggest that the dealing was not on the basis of that inside information (always assuming, it is suggested, that the dealer was not on the side of the Chinese wall which had access to the information).[403]

The sorts of activity which will not constitute market abuse in the ordinary course of events include the legitimate business of market makers, assuming that the dealings can be demonstrated (it is suggested) to be demonstrably in accordance with the ordinary course of such business;[404] the execution of client orders (assuming, it is suggested, that those client orders are in the ordinary course of business and are not predicated on that inside information);[405] the proper conduct of a takeover or merger including preparations for such a takeover or merger,[406] although the information that an offer is to be made is itself inside information.[407]

(2) Disclosure of inside information: "improper disclosure"

The second form of behaviour constituting market abuse is akin to the disclosure of inside information offence, as set out in s.118(3) of the FSMA 2000 in the following terms:

> 'The second is where an insider discloses inside information to another person otherwise than in the proper course of the exercise of his employment, profession or duties.'

The second form of market abuse behaviour is therefore committed where an insider discloses information to another person. This could be done by letter, by e-mail, or verbally to a single person or, it is suggested, to a number of people (each of whom would constitute "another person") whether to a particular individual or to any agent of a legal person. The recipient of the information could be someone who is intended to disseminate that information or who intends to profit from it personally or who intends to do nothing at all: the subsection does not require any particular motive or reaction on the part of the recipient of that disclosure. The exemption from liability here is where the disclosure is made by a person in "the proper course of the exercise of his employment, profession or duties". Thus an officer of a company sending information to a RIS would

[400] MAR, 1.3.3E.
[401] MAR, 1.3.20G through 1.3.23.
[402] MAR, 1.3.4E.
[403] MAR, 1.3.5E.
[404] MAR, 1.3.7C; MAD recital 18.
[405] MAR, 1.3.12C; MAD, recital 12.
[406] MAR, 1.3.17C; MAD, recital 29.
[407] MAR, 1.3.18G.

be acting properly in the course of his employment; a solicitor transmitting information as part of disclosure proceedings in litigation further to a court order would be acting properly in the course of a profession; and a public relations consultant transmitting the information at the behest of the issuer properly to an appropriate newspaper would be acting in the course of his duties.

The FSA gives two examples of behaviour which it considers would fall within this head of behaviour in MAR:[408]

> '(1) disclosure of inside information by the director of an issuer to another in a social context; and
> (2) selective briefing of analysts by directors of issuers or others who are persons discharging managerial responsibilities.'

The former, it is suggested, is akin to information being passed casually at a social gathering; and the latter relates to the problem of directors talking to representatives of some of their institutional investors and others in small groups in a way which constitutes the passage of information which is still inside information due to the smallness of the group in question. Disclosure will not constitute market abuse, however, if the disclosure is party of a body's proper functions or if it is made to a proper authority such as a government department, the Bank of England, the Competition Commission, the Takeover Panel or any other such regulatory body.[409] A part of the acid test for proper disclosure in this context is whether or not the disclosure was part of the approved procedure on the market in question – for example, in relation to the code on takeovers or as required by the FSA's Listing Rules – because such a circumstance would tend to suggest that the disclosure was properly made. Otherwise, the person making the disclosure would have to demonstrate that the disclosure was made in the proper discharge of his ordinary duties. Other specific examples are given in MAR.[410]

(3) Use of inside information in breach of standard of reasonable behaviour on the market: "misuse of information"

The third form of behaviour draws on s.118(2) and (3) of the FSMA 2000 in the following terms, further to s.118(4) of the FSMA 2000 (it should be noted that this provision ceased to have effect in June 2008):[411]

> 'The third is where the behaviour (in falling within subsection (2) or (3)) –
>
> > (a) is based on information which is not generally available to those using the market but which, if available to a regular user of the market, would be, or would likely to be, regarded by him as relevant when deciding the terms on which transactions in qualifying investments should be effected, and

[408] MAR, 1.4.2E.
[409] MAR, 1.4.3C.
[410] MAR, 1.4.6G and 1.4.7G.
[411] Financial Services and Markets Act 2000, s.118(9): subsection (4) and the definition of "regular user" in section 130A(3) cease to have effect on 30 June 2008 and subsection (1)(b) is then to be read as no longer referring to those subsections.

(b) is likely to be regarded by a regular user of the market as a failure on the part of the person concerned to observe the standard of behaviour reasonably expected of a person in his position in relation to the market.'

It is required, therefore, that three things have occurred. First, the information must not be generally available. Secondly, the information must be of a type which would have been regarded as relevant information by a regular user of the market when deciding whether or not to make an investment in the relevant securities. Thirdly, on the balance of probabilities a regular user of the market – akin, therefore, to a reasonable person in this context – must consider the defendant's actions to have been a failure to observe proper market conduct. It is suggested that this last requirement is one way of formulating the notion that the defendant must act with integrity – as under the *FSA Principles for Businesses* – in that the notion of integrity is being measured by reference to the reasonable, regular market user. Clear examples of situations in which information should be disclosed or not dealt on include any circumstance in which FSA regulation requires disclosure of information or the withholding of that information respectively;[412] similarly information which would ordinarily be disclosed on a RIS (such as a change in rating by a ratings agency) should be disclosed.[413]

The FSA gives examples of behaviour which it considers would fall within this head of behaviour in MAR. Dealing in qualifying securities on information which is not generally owned, even if it is not inside information, is considered by the FSA to be market abuse.[414] Indeed, any dealing based on information which is not generally owned, even if it is not inside information, is considered by the FSA to be market abuse.[415]

It is not required that the user of the information was an insider nor a regulated person: this could therefore apply to an ordinary tippee. One clear example given of market abuse in MAR is that in which the director of a target company in a takeover offer tells a friend at lunch that the company is subject to such an offer, and that friend then places a bet at fixed odds with a bookmaker that the company will be subject to a bid: this constitutes market abuse on the basis of misuse of information.[416] Similarly, if the same process occurred, in relation to a bet placed by a friend after lunch, but in relation to a "non-contractual icing" of takeover negotiations – that is, where the parties agreed in private to discontinue the takeover without publicising that information – then there would also be market abuse.[417]

It is not only that the behaviour relates directly to the securities but rather it can also be that the behaviour is carried on by reference, for example, to derivatives whose value is derived from those securities. Thus market abuse can be committed by people who speculate indirectly on the performance of those securities but who are nevertheless acting in a way which is abusive and which also depends on the performance of those securities. Thus, in s.118A(3) of the FSMA 2000, "the behaviour that is to be regarded as occurring in relation to qualifying investments" includes "behaviour which occurs in relation to anything that is the subject matter, or whose price or value is expressed by

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[412] MAR, 1.5.7(1)E.
[413] MAR, 1.5.7(2)E.
[414] MAR, 1.5.3(1)G.
[415] MAR, 1.5.3(2)G.
[416] MAR, 1.5.10(1)E.
[417] MAR, 1.5.10(2)E.

reference to the price or value of the qualifying investments" or behaviour which "occurs in relation to investments (whether or not they are qualifying investments) whose subject matter is the qualifying investments".[418]

(4) Causing a false or misleading impression: "manipulating transactions"

The fourth form of behaviour constituting market abuse is akin to the disclosure of inside information offence, as set out in s.118(5) of the FSMA 2000 in the following terms:

> 'The fourth is where the behaviour consists of effecting transactions or orders to trade (otherwise than for legitimate reasons and in conformity with accepted market practices on the relevant market) which –
>
> > (a) give, or are likely to give, a false or misleading impression as to the supply of, or demand for, or as to the price of, one or more qualifying investments, or
> >
> > (b) secure the price of one or more such investments at an abnormal or artificial level.'

The essence of this head of behaviour is artificiality. That is, if the dealer can justify the transactions – for example, if there is some pre-existing investment strategy which required the dealing to be made, or if it was part of a pre-existing legal obligations – then the dealing will not constitute market abuse. Otherwise if transactions are made either with a view to giving a "false or misleading impression" as to the marked demand for or price of securities, or to fix that price at an artificial level,[419] then there will be market abuse.[420] An example given in MAR of such behaviour is the acquisition of securities just before close of trading with a view to making the closing price of those securities seem markedly higher than otherwise it would have been.[421] Similarly, so-called 'wash trades', in which securities appear to be bought and sold but in relation to which there is no change in beneficial ownership, will be market abuse when their object is to make it appear that there is a demand for those securities which does not exist, and at a price at which there is no market.[422] Another form of orchestrated market abuse in this context is the abuse of a dominant position in the market for particular securities so as to manipulate the market price of those securities.[423]

(5) Employing fictitious devices or contrivances: "manipulating devices"

The fifth form of behaviour constituting market abuse is akin to the disclosure of inside information offence, as set out in s.118(6) of the FSMA 2000 in the following terms:

> 'The fifth is where the behaviour consists of effecting transactions or orders to trade which employ fictitious devices or any other form of deception or contrivance.'

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[418] Financial Services and Markets Act 2000, s.118A(3).
[419] MAR, 1.6.10E.
[420] Examples are given at MAR, 1.6.15E.
[421] MAR, 1.6.2(1)E; MAD, art. 1.2(c).
[422] MAR, 1.6.2(2)E.
[423] MAR, 1.6.4(1)E.

Evidently the use of deception, fictitious devices and contrivances will constitute market abuse when they are conducted, in the view of the FSA, to take a benefit from the resultant, anticipated effect on the value of the securities in question. The FSA gives a number of examples in MAR of this sort of behaviour, as set out in the following paragraphs.

First, taking advantage of access to a regular media channel to communicate opinions which are calculated to affect the price of securities so as to lead to a beneficial effect for positions already held by the person making those comments.[424] This first example is difficult. In most circumstances when asked to make a comment, a person is likely to praise securities which he expects to perform well and to cast doubt on securities which he expects to perform poorly. That would be the case if the interviewee were simply telling the truth. It would be reasonable to suppose that such a person would also have structured his portfolios to mirror those views. This exercise in truth-telling may then influence the market value of those securities. Consequently, giving an honest opinion would tend to influence the price of those securities in the manner and in the direction indicated by the interviewee's comments. This, it is suggested, ought not to constitute market abuse because it is a feature and a result of ordinary trading. If this were to be considered to be market abuse then that would be to require all interviewees to hedge their comments and to dissemble so that they did not inadvertently cause a movement in market prices simply by voicing a genuinely-held opinion. By contrast, a maverick view expressed on such media which was expressed with a view to moving a market solely for the purposes of taking a benefit from a position on the securities in question would constitute market abuse. Such an interviewee would be speaking solely to move a market in a way which would realise a gain for him. Again, the artificiality involved in this situation, and the concomitant market manipulation involved, would be significant.[425]

Clearer FSA guidance would be required, it is suggested, if what the FSA wanted was to dissuade respected market participants from voicing their genuinely-held views about securities in the media; whereas people who deliberately misstate their views solely to move a market for personal gain would clearly be manipulating a market. The difficult case would be a person who voiced a genuinely-held belief in the strength of a given company with the result that his previous acquisition of shares in that company rose steeply in value after he tipped them or praised them in the media: here a market would have been manipulated, a personal gain would have been realised, but there would have been no artificiality in the views expressed. It is suggested that honesty ought not to be penalised if there is no intention to realise a gain which would not otherwise have been realised in tolerably predictable market conditions. Thus voicing support for a share in which one has already invested ought not to be market abuse if one is simply giving voice to a genuine belief that a particular share is a good bet. It would be an odd trader who did not back his own tips; or, rather, who did not invest in accordance with his own views of future market performance. The FSA would either have to ban such people from talking; or accept that one will invest in securities which one believes will rise, and that if the media interviews market participants then they will voice their opinions.

Discretion would be required, however, it is suggested, in relation to unknown takeovers currently in negotiation and similar events. An interviewee would need not to let slip any

[424] MAR, 1.7.2(1)E.
[425] MAR, 1.7.2(1)E.

inside information to which he was privy either directly – by telling the world in a slip of the tongue that a takeover was in the offing – or indirectly – by hinting knowingly that the companies in question are involved in activities which are likely to help their prospects – because that would be to move a market. Genuinely inadvertent slips would be disastrous and embarrassing for secret negotiations, but need not be thought to be market abuse. Evidently, a professional with that sort of information would be well-advised to avoid media interviews so as to avoid the risk of such slips. This genuine error should be contrasted with a deliberate "slip" which was made with a view to driving the market.

Secondly, transactions which are performed to hide the beneficial ownership of property, for example to avoid transparency obligations under Part 43 of the Companies Act 2006 (as discussed in Chapter 40), will be presumed to constitute market abuse.[426] Thirdly, "pump and dump" transactions in which misleadingly positive rumours about securities in which a long position has been taken, so as to increase the price of those securities with a view to selling them off when the price rises sufficiently, are market abuse.[427] Fourthly, "trash and cash" transactions in which a short position is taken, the inverse to the preceding example, with a view to depressing the price of the securities, will constitute market abuse.[428]

Frequently, such manipulating devices will involve the dissemination of false information, particularly when linked to dealing around the time of that dissemination of information by the same person or connected people.[429] It is suggested, that this need not be restricted to disseminations of false information; instead, it might also involve the dissemination solely of positive information with the concomitant suppression of negative information (particularly if it was information required to be disclosed by ordinary market practice or regulation), so as to have the same effect as disseminating literally false information.

(6) The dissemination of information giving a false or misleading impression: "dissemination"

The sixth form of behaviour constituting market abuse is akin to the disclosure of inside information offence, as set out in s.118(7) of the FSMA 2000 in the following terms:

> 'The sixth is where the behaviour consists of the dissemination of information by any means which gives, or is likely to give, a false or misleading impression as to a qualifying investment by a person who knew or could reasonably be expected to have known that the information was false or misleading.'

Akin to the preceding head of behaviour, disseminating false information will constitute market abuse. There is nothing in the drafting of this subsection which requires that this was done with the effect of generating a profit nor that it was even done with a view to

[426] MAR, 1.7.2(2)E.
[427] MAR, 1.7.2(3)E.
[428] MAR, 1.7.2(4)E.
[429] MAR, 1.7.3E.

generating such a profit. Simply acting in a planned manner so as to create a false impression as to the securities will constitute market abuse under this head.[430]

There are clearly issues as to the behaviour of journalists in such contexts. Newspaper stories, as was discussed in relation to insider dealing, can drive the price of securities. Prior knowledge of a newspaper or other significant journal publication may therefore be inside information. Similarly, the abuse of journalistic sources can also disseminate false stories or can generate interest in securities and possibly create a market where none otherwise existed. Therefore, the question arises as to the potential liability of journalists themselves for market abuse. Section 118A(4) of the FSMA 2000 provides that the dissemination of information by a person acting in the capacity of a journalist is to be assessed by taking into account the codes governing his profession unless he derives, directly or indirectly, any advantage or profits from the dissemination of the information.[431]

(7) Failure to observe standard of behaviour reasonably expected of a person in that market: "misleading behaviour and distortion"

The seventh form of behaviour constituting market abuse is akin to the disclosure of inside information offence, as set out in s.118(8) of the FSMA 2000 in the following terms (it should be noted that this provision will cease to have effect in June 2008):[432]

> 'The seventh is where the behaviour (not falling within subsection (5), (6) or (7) [the three preceding types of behaviour]) –
>
> > (a) is likely to give a regular user of the market a false or misleading impression as to the supply of, demand for or price or value of, qualifying investments, or
> >
> > (b) would be, or would be likely to be, regarded by a regular user of the market as behaviour that would distort, or would be likely to distort, the market in such an investment,
>
> and the behaviour is likely to be regarded by a regular user of the market as a failure on the part of the person concerned to observe the standard of behaviour reasonably expected of a person in his position in relation to the market.'

One of the examples which MAR gives of this form of market abuse is the movement of physical commodity stocks to give the appearance that there is a greater supply of that commodity than is actually the case.[433] Similarly, the movement of an empty cargo ship with a view to creating the impression of an increased supply would constitute market abuse.[434] Much depends on the market in question and the likely impact of particular types of distortion on regular users of that market, as well as the status of the person effecting that distortion the information and the regulatory requirements of the market in

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430 See MAR, 1.8.3E.
431 Financial Services and Markets Act 2000, s.118A(4).
432 Financial Services and Markets Act 2000, s.118(9): subsection (8) and the definition of "regular user" in section 130A(3) cease to have effect on 30 June 2008 and subsection (1)(b) is then to be read as no longer referring to those subsections.
433 MAR, 1.9.2(1)E.
434 MAR, 1.9.2(2)E.

question.[435] Thus, for example, behaviour in compliance with the requirements imposed on holders of long positions in the "metal market aberrations regime" will not constitute distortion.[436]

It is not only that the behaviour relates directly to the securities but rather it can also be that the behaviour is carried on by reference, for example, to derivatives whose value is derived from those securities. Thus market abuse can be committed by people who speculate indirectly on the performance of those securities but who are nevertheless acting in a way which is abusive and which also depends on the performance of those securities. A clear manipulation strategy would be to acquire a series of cash-settled call options, exercisable over a period of time, which set the strike price for the securities at a much lower price than the buyer knows those securities will reach once his inside information is released into the market so as to increase the price of those securities. In this way, without actually acquiring a single security, the buyer of the options will receive a cash settlement amount under each option equivalent to the amount he would have received if he had actually bought securities at the price specified in the option and then actually sold them on the open market.[437] Thus, in s.118A(3) of the FSMA 2000, "the behaviour that is to be regarded as occurring in relation to qualifying investments" includes "behaviour which occurs in relation to anything that is the subject matter, or whose price or value is expressed by reference to the price or value of the qualifying investments" or behaviour which "occurs in relation to investments (whether or not they are qualifying investments) whose subject matter is the qualifying investments".[438] This would cover financial derivatives, such as options, used to speculate on the price of securities.

The meaning of the term "insider"

The type of person who must abuse the inside information is an "insider". Section 118B of the FSMA 2000 provides that:

> 'For the purposes of this Part an insider is any person who has inside information–
>
> > (a) as a result of his membership of an administrative, management or supervisory body of an issuer of qualifying investments,
> > (b) as a result of his holding in the capital of an issuer of qualifying investments,
> > (c) as a result of having access to the information through the exercise of his employment, profession or duties,
> > (d) as a result of his criminal activities, or
> > (e) which he has obtained by other means and which he knows, or could reasonably be expected to know, is inside information.

Therefore, one is an insider if, first, one has inside information and, secondly, if one has that inside information as a result of one of the offices or activities in paragraphs (a)

[435] See generally MAR, 1.9.4E.
[436] MAR, 1.9.3C.
[437] For a discussion of options, see Alastair Hudson, *The Law on Financial Derivatives* (4e, Sweet & Maxwell, 2006), para 2-30 *et seq*.
[438] Financial Services and Markets Act 2000, s.118A(3).

through (e) above. The issues concerning whether or not one is an insider were considered in relation to the similar concept in the criminal offence of insider dealing earlier in this chapter. A part of this definition of an "insider" is the definition of what constitutes "inside information", which is considered in the next paragraph.

"Inside information"

The general definition of "inside information"

Section 118C(2) of the FSMA 2000 provides that "inside information" is defined in the following way for the purposes of the market abuse provisions:[439]

> '(2) In relation to qualifying investments, or related investments, which are not commodity derivatives, inside information is information of a precise nature which –
>
> > (a) is not generally available,
> > (b) relates, directly or indirectly, to one or more issuers of the qualifying investments or to one or more of the qualifying investments, and
> > (c) would, if generally available, be likely to have a significant effect on the price of the qualifying investments or on the price of related investments.'

There are therefore four elements to this definition which are conjunctive. The first requirement that the information be of a "precise nature" excludes rumours and similar information. The remaining three requirements require that the information not be generally available, that it relates to listed companies or securities, and that it would have a significant effect on the price of those securities if generally known. There is reference to misuse of inside information being performed by an "insider".

Whether or not information is "precise"

It has been a requirement of some of the provisions considered thus far that the information in question must be "precise" if it is to be inside information. In this regard, s.118C(5) of the FSMA 2000 provides that:

> '(5) Information is precise if it –
>
> > (a) indicates circumstances that exist or may reasonably be expected to come into existence or an event that has occurred or may reasonably be expected to occur, and
> > (b) is specific enough to enable a conclusion to be drawn as to the possible effect of those circumstances or that event on the price of qualifying investments or related investments.'

This definition needs to read in the context in which the term 'precise' is used in s.118C to define "inside information" and then how that term is used in the market abuse code. That is, the inside information must relate to one of the types of entity described in s.118 of the FSMA 2000 (as considered above) by one of the types of person described in

[439] Financial Services and Markets Act 2000, s.118B(1).

s.118. Those types of behaviour were much more tightly drawn than the definition of "precise" which refers generally to "circumstances" and not to any particular quality of circumstance. So, "precise" does not identify whether it is financial information relating to one company or any unpublished information relating to a market sector generally which are covered. In consequence, the statutory language would permit any of these possibilities.

Whether or not information will have a "significant effect"

It has been a requirement of some of the provisions considered thus far that the information in question must be such as to have a "significant effect" on the price or value of qualifying securities if it is to be inside information. In this regard, s.118C(6) of the FSMA 2000 provides that:

> '(6) Information would be likely to have a significant effect on the price if and only if it is information of a kind which a reasonable investor would be likely to use as part of the basis of his investment decisions.'

For the purposes of defining "significant effect" in the market abuse code the test is a version of the reasonable investor test found in relation to the general duty of disclosure in s.87A of the FSMA 2000 in relation to information which is necessary in a prospectus to enable an investor to make an informed assessment about securities. Therefore, in deciding whether or not information would have a significant effect on the value of the securities we are required to consider whether or not a reasonable investor would be likely, not simply that he might, to use that information as a part, but not the sole factor, in his investment decision-making.

Generally availability of information

A key aspect of information being inside information is that it is, in effect, privy to insiders. Once information is generally available, it is no longer inside information by that definition. That is, the information loses its "inside" quality once it is known generally. However, diligent and perfectly lawful hard work by market analysts is likely to be able to predict market pressures impacting on companies and in turn on their profitability, or on the likelihood of mergers between certain types of entity. So, to take two random examples, the effect of widespread flooding in England which ruins crops is likely to raise the cost of raw materials for food production companies and so squeeze their profit margins; or the trend for mergers between large financial institutions with useful synergies might lead analysts to predict mergers of that sort. These predictions might take place at the same time as the managers of those companies are wrestling with exactly these issues. If the market analysts' then learn the sort of information which might be gleaned at a meeting between institutional investors and the finance directors of public companies, and so advise their traders to make investments at a time which would have caused suspicions of insider dealing in other people, then the question arises as to the possibility that there has been market abuse. Section 118C(8) provides that:

> '(8) Information which can be obtained by research or analysis conducted by, or on behalf of, users of a market is to be regarded, for the purposes of this Part, as being generally available to them.'

So, analysis which unearths information which is not generally available to the market is nevertheless to be treated, correctly, as having been generally available to the analyst and his principals. The key question is as to the source of the information which went into that analysis: if the source was a legitimate source not tainted by being inside information as defined generally in s.118C, it is suggested, then an investment made purely on that analyst's advice will not have been made using inside information. The source of the information which comprised the prediction is then the key question.

The FSA's power to impose penalties in cases of market abuse

The circumstances in which penalties will be imposed

Section 123 of the FSMA 2000 provides the FSA with the power to "impose a penalty of such amount as it considers appropriate" on a person who has engaged in market abuse or who has encouraged another person to engage in market abuse.[440] Section 129 of the FSMA 2000 provides the court with a power to give directions as to the nature of a penalty in the form of a fine which should be payable to the FSA in a case of market abuse. Further to s.123(1)(b) of the FSMA 2000, the FSA may impose a penalty on a person whom the FSA is satisfied has either "required" or "encouraged" another person to engage in behaviour which would have been market abuse if performed by that first person. This requirement or encouragement can be caused by an action or by an omission.[441] The FSA is empowered to direct a recognised investment exchange or clearing house to suspend any investigations which it might be making under its own rules when the FSA considers it expedient or desirable because the FSA may exercise one its powers under the market abuse code. Instead of imposing a penalty by way of a fine, the FSA is empowered to publish a statement that the defendant engaged in market abuse.[442] Any action taken under s.123 must be given way of a decision notice with a right to refer the matter to the FSA Market Tribunal.[443] The FSA is required to publish statements of policy in relation to its approach to penalties[444] and statements of procedure in relation to those same matters.[445]

Relief from the penalty

The penalty is not to be imposed if the FSA is satisfied that the defendant reasonably believed that she was not committing market abuse, nor encouraging or requiring others to do so.[446] Alternatively, the penalty is not to be imposed if the FSA is satisfied that the

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[440] Financial Services and Markets Act 2000, s.123(1).
[441] Financial Services and Markets Act 2000, s.123(1)(b).
[442] Financial Services and Markets Act 2000, s.123(3).
[443] Financial Services and Markets Act 2000, s.127
[444] Financial Services and Markets Act 2000, s.124.
[445] Financial Services and Markets Act 2000, s.125.
[446] Financial Services and Markets Act 2000, s.123(2)(a).

defendant "took all reasonable precautions and exercised all due diligence" to avoid behaving in a manner which would constitute market abuse.[447]

The regulation of "inside information" under the Listing Rules' Model Code

The FSA regulates misuse of inside information under the listing rules by means of the Model Code in Annex 1 to Chapter 9 of the Listing Rules. This code requires that the instrument in question be one which is traded on an existing market and in which there is a continuing market. The types of behaviour caught within this regime relate not only to dealings directly in securities but also to any behaviour which affects their value more generally.[448] Further, that behaviour may take place in another jurisdiction but nevertheless have an impact on instruments traded in the United Kingdom and so fall within the market abuse code.[449] Market standards will be of great importance in the application of the code, given the importance given over in that code to close consideration of the norms usually applied particular markets[450] in particular when seeking to apply the "reasonable user" test outlined above.[451]

Dealings with a listed companies' securities form the focus of the Model Code particularly when they are conducted in a prohibited period by the use of inside information by any person who is "discharging managerial responsibilities" or who is an "insider employee". The "prohibited period" provision relates to "any close period" or "any period when there exists any matter which constitutes inside information in relation to the company",[452] perhaps during the lead-up to an announcement of a merger or before an exceptional announcement involving profit forecasts via a recognised information service. The "close period" refers to the 60 day period before the preliminary announcement of the company's annual results or half-yearly results (as appropriate), or 30 days before the preliminary announcement of quarterly results (if appropriate).[453] Therefore, dealings with listed securities within a "prohibited period" using inside information by any restricted person are prohibited[454] unless they have clearance to deal with those transactions.[455] There is an obligation on restricted persons discharging managerial responsibilities to take 'reasonable steps to prevent any dealings by or on behalf of any connected person of his in any securities of the company on

[447] Financial Services and Markets Act 2000, s.123(2)(b).
[448] MAR 1, 1.11.8E.
[449] MAR 1, 1.2.9G.
[450] MAR 1, 1.2.3E.
[451] Cf. *Polly Peck v. Nadir* [1992] 4 All ER 769 where an objective test of reasonableness is used in relation to a claim for knowing receipt but where that objectivity is tempered by making reference to a "reasonable banker" in relation to financial transactions and not simply to an average person who may or may not have any banking knowledge. The standard used by the legislation of a hypothetical "reasonable user" of the market is intended to replicate the "reasonable man" test used frequently by the common law to establish a level of objectivity but while also retaining some recognition of the particular context within which that defendant is operating; thus creating a test more akin to the "average trader on the Stock Exchange" than "the man on the Clapham omnibus".
[452] Listing Rules, Chap. 9, Annex 1, para. 1(e).
[453] Listing Rules, Chap. 9, Annex 1, para. 1(a).
[454] Listing Rules, Chap. 9, Annex 1, para.3.
[455] Listing Rules, Chap. 9, Annex 1.3, in accordance with the procedure set out at Listing Rules, Chap. 9, Annex 1.4.

considerations of a short term nature'.[456] Transactions by restricted persons which fall within this code must be made public in accordance with the Disclosure and Transparency Rules.[457]

In general terms, the FSA Disclosure and Transparency Rules oblige an issuer to notify a recognised information service "as soon as possible"[458] of any inside information which "directly concerns the issuer",[459] unless the issuer (on its own initiative) considers the prevention of disclosure to be necessary to protect its own "legitimate interests".[460] The term "legitimate interests" is not defined but examples given in the Disclosure Rules of matters which may impact on a company's legitimate interests include negotiations which are train and the public awareness of which may have affect them adversely, or contracts entered into by one part of a company (such as a management board) but which require ratification by another part of the company (such as a supervisory board).[461] Disclosure in general terms must be full disclosure and not selective disclosure[462] except in relation to the preservation of duties of confidentiality[463] or, impliedly, to protect its legitimate interests. When dealing with rumours or speculation about the company then the company must assess whether or not that speculation is of a type that the company is in possession of inside information by knowing the true state of affairs (impliedly assuming there is not already inside information which requires publication).[464]

[456] Listing Rules, Chap. 9, Annex 1, para.20.
[457] See Disclosure and Transparency Rules, section 3.1 generally; see also Market Abuse Directive, art. 6.
[458] This will be satisfied if the issuer acted as soon as was possible in the circumstance of factors which were only gradually coming to light: Disclosure and Transparency Rules, Chap. 2, para, 2.2.2R. A short delay in publication of the information will be acceptable if it is "necessary to clarify the situation": Disclosure and Transparency Rules, Chap. 2, para, 2.2.9G.
[459] Disclosure and Transparency Rules, Chap. 2, para, 2.2.1R.
[460] Disclosure and Transparency Rules, Chap. 2, para, 2.5.1R. See Market Abuse Directive ("MAD"), art. 6(1).
[461] Disclosure and Transparency Rules, Chap. 2, para 2.5.3R.
[462] Disclosure and Transparency Rules, Chap. 2, para 2.5.6R. See MAD, art. 6(3).
[463] Disclosure and Transparency Rules, Chap. 2, para 2.5.7G.
[464] Disclosure and Transparency Rules, Chap. 2, para 2.7.1R.