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# To fear or not to fear – a redundant question?

*The FSA's crackdown on market misconduct continues apace, with the ramping-up of its criminal capability finally starting to reap dividends and record fines imposed for civil market abuse. There is a certain irony, therefore, in the new coalition government's recent announcement that it will, in due course, strip the FSA of its role as policeman of the markets by creating a single agency to tackle economic crime, writes **Toby Robinson** of Travers Smith. This article looks at the various high profile criminal insider dealing proceedings that have been brought by the FSA as well as some of the recent market abuse Final Notices and Financial Services and Markets Tribunal decisions.*

## Criminal proceedings

Whereas the FSA has regularly used and will continue (assuming – which is entirely unclear as things stand - it retains responsibility for tackling civil market abuse and other non-criminal transgressions) to use its regulatory powers to discipline those who engaged in market misconduct, it had, until relatively recently, shied away from using its criminal enforcement powers. This historical reluctance, long the subject of criticism from various quarters, was no doubt due to a combination of factors such as: (i) the stringent two-fold test to be met under the Code for Crown Prosecutors; (ii) the higher burden of proof; (iii) historical problems with getting a jury to convict; (iv) the opportunity for a "quick fix" afforded by the early settlement discount procedure; and (v) the absence of a need to prove intent under the regulatory regime. If there was any lingering doubt that criminal prosecutions now form a central plank of the FSA's "credible deterrence" strategy, that has surely now been dispelled, albeit that it is a plank which appears likely to be taken away from it shortly.

In March 2009, the FSA secured its first criminal insider dealing conviction when Christopher McQuoid, general counsel at TTP Communications was sentenced to eight months in prison after his father-in-law, James Melbourne, bought shares in TTP two days before Motorola's takeover of TTP became public. Melbourne, who split his £49,000 profit with McQuoid, received the same sentence, suspended for a year. McQuoid appealed against his sentence on the somewhat spurious ground that his case happened to be under consideration at the time the FSA decided to change policy as to whether to proceed by way of prosecution, rather than, as before, regulatory enforcement for market abuse. Giving this argument short shrift, the Court, echoing numerous statements to similar effect from Margaret Cole, made it clear that "when it is done deliberately, insider dealing is a species of fraud; it is cheating." It continued: "Prosecution will often and perhaps more so now than in the past, be appropriate. Although [perpetrators] may hope, if caught, to escape with regulatory proceedings, they can have no legitimate expectation of avoiding prosecution and sentence."

In November 2009, Matthew Uberoi, a dentist, and his son Neel were found guilty of insider dealing and received jail terms of two years and one year respectively after Uberoi senior made profits of approximately £110,000 arising out of takeover deals that Hoare Govett, where Uberoi junior had been working as an intern, were advising on.

The *Uberoi* and *McQuoid* cases attracted much attention because they were the first ever insider dealing convictions secured by the FSA. However, these were not the high profile convictions so coveted by the FSA. That changed in March 2010, when Malcolm Calvert, a former partner at Cazenove, was sentenced to 21 months in prison and fined £524,000 (vastly exceeding his profits on the trades) after passing on inside information to a friend, Bertie Hatcher, who purchased shares and shared the profits with Calvert. This was despite the fact that the original source of the inside information (allegedly within Cazenove) was never uncovered. Quite apart from Calvert's relatively high profile within the City and tales of wads of cash in envelopes being handed over at the races, this case is of particular interest given the immunity from prosecution offered to Hatcher in return for his giving

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"valuable evidence" (see the Final Notice in respect of Hatcher published on 10 March 2010, the day Calvert was convicted [1]) against Calvert.

It will be interesting to see whether this case and the *Ahmad* case (see below) lead to more and more individuals seeking to strike a deal with the FSA (or the new agency) in exchange for giving evidence against others. It is rare in these types of cases to find the smoking gun needed to prove beyond reasonable doubt that criminal conduct (or on the balance of probabilities that market abuse under FSMA) has taken place, hence Margaret Cole's statement in the FSA's press release relating to Calvert's conviction that the FSA was "mindful of the need to encourage others to come forward and assist in the investigation and prosecution of insider dealing and market abuse" and hence no doubt why Hatcher's fine of £56,098 was limited to his profits from the illicit trades.

In addition to the above, there are a number of other insider dealing prosecutions under way. The trial of Andrew King, former finance director of NeuTec Pharma, Michael McFall and Andrew Rimmington (both City lawyers) arising out of alleged insider dealing relating to takeover talks between NeuTec and Novartis began on 19 April 2010. The trial date of Neil Rollins, charged with four counts of insider dealing, has yet to be fixed. Christian Littlewood and his wife have been charged with 14 counts of insider dealing and a third person has been extradited from the Comoros Islands and subsequently charged in connection with the same trades. On 31 March 2010, seven people were charged (a warrant for the arrest of another individual has been issued) in connection with the FSA's Project Saturn insider dealing investigation. This followed the high profile arrest of eight individuals in July 2008, a vast document review exercise by the FSA and the taking of over 250 witness statements.

In perhaps the most high profile swoop to date, 16 premises were raided by the FSA and the Serious Organised Crime Agency (SOCA) in the early hours of 23 March 2010 and seven men were arrested following a joint FSA/SOCA investigation that began in late 2007. According to the press, those arrested include senior individuals from Deutsche Bank, Exane Limited and Moore Capital. No charges have yet been brought but there is little doubt that these arrests have caused a huge stir. Failure to secure convictions in this case would be a major blow for the FSA / the new agency.

On 28 April 2010, a former hedge fund trader, Anjam Ahmad, was charged with one count of conspiracy to commit insider dealing. This followed the arrest of three men at the end of January. On 18 May, Ahmad pleaded guilty and will be sentenced on 22 June. His guilty plea, together with his cooperation in the prosecution of the other two individuals, is expected to lead to a reduced sentence. Most recently, on 19 May the FSA announced that a 39-year old man had been arrested "to facilitate questioning under caution in relation to allegations of insider dealing". Finally, it remains to be seen whether or not charges will be brought against the six individuals dawn raided on 27 May 2009 in connection with "suspected organised insider dealing".

## Civil enforcement

With most of the press comment focussed on the recent flurry of high profile arrests and convictions, it would be easy to lose sight of the fact that the FSA has continued to bring successful civil market abuse actions.

On 22 April 2010, the Court of Appeal upheld the Tribunal's finding that Winterflood Securities Limited and two of its employees had engaged in market abuse in relation to a share ramping scheme in which Winterflood was the market maker. The Court's starting point (unchallenged) was that the definition of market abuse in FSMA does not require the person engaging in the behaviour in question to have intended to abuse the market (as the Code of Market Conduct makes clear). However, Winterflood sought to rely on provisions in the Code of Market Conduct in force at the relevant time suggesting that for transactions creating a false or misleading impression or distorting the market, the FSA needed to establish that there was an "actuating purpose" to mislead or distort the market. The Court of Appeal agreed with the Tribunal that the provisions of the Code in question did not contain an implicit statement that where no actuating purpose is present there can be no market abuse. As a result, Winterflood was fined £4,000,000 (£900,000 of which related to disgorgement of profits) and the employees were fined £200,000 and £50,000 respectively.

On 21 May 2010, the FSA published its Final Notice in the related case of Simon Eagle, the architect of the share ramping scheme. Eagle, who abandoned his reference to the Tribunal, was found to have committed deliberate market abuse, banned from working in financial services and fined a whopping £2.8 million (disgorgement of £1.3 million profit and a punitive element of £1.5 million), easily surpassing the £750,000 fine imposed on Philip Jabre in 2006 and the recent £967,005 fine imposed on Mehmet Sepil (see below). The size of fine is all the more

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remarkable given that Eagle is publicly pleading poverty, having been bankrupted in 2005.

In January 2010, the Tribunal decision in the case of Robin Chhabra and Sameer Patel (only the second Tribunal market abuse decision since 2006 – the first being *Winterflood*) was publicised. Chhabra and Patel were each banned and fined £95,000 and £180,500 respectively. This case is notable for the fact that the findings of market abuse were based largely on the assessment of the reliability of inferences drawn from circumstantial evidence. Although, as described above, market misconduct cases by their very nature often involve purely circumstantial evidence (for example, see the Final Notice dated July 2008 in respect of John Shevlin [2]), it is only in those rare cases where references are made to the Tribunal that such evidence is properly tested by judges or quasi judges.

The FSA's victory in the *Chhabra* and *Patel* cases will have given it a significant boost and has perhaps gone some way towards lightening its mood following the failure to secure a Prohibition Order or even a fine in the Dresdner bond trader cases (Final Notices dated October 2009). [3] It was perhaps with these latter cases in mind that the FSA took on board the concerns, raised by various respondents to the proposal in CP09/19 ("Enforcement financial penalties"), that the minimum penalty for market abuse cases against individuals should be £100,000. This was viewed as too harsh and disproportionate. The FSA has now (rightly, it is submitted) had a change of heart and PS10/4 states that the minimum £100,000 penalty will now only apply in the most serious of market abuse cases, typically where the market abuse was deliberate.

In February 2010, Final Notices were issued in respect of three executives of a Turkish oil company, Genel Enerji, accused of dealing in shares of another oil company, Heritage Oil plc, Genel Enerji's partner in a joint venture arrangement. In the knowledge that the joint venture's drilling results were positive, the three executives purchased shares in Heritage the day before the results were announced. The case is of particular interest because of the level of fines. The CEO of the company, Mehmet Sepil, was fined £967,005, comprising disgorgement of profits (£267,005) and a punitive element of £700,000. The other two executives were fined £105,240 and £94,062 respectively. The £967,005 fine is the second largest market abuse fine meted out on an individual by the FSA. No doubt Sepil's personal wealth and position of responsibility were factors, but, as the FSA found, he did not intend to commit market abuse, nor was he aware of the UK's market abuse regime. Furthermore, he had, subsequent to the trades, sought legal advice as to the propriety of his share dealing and self-reported to the FSA on the back of that advice.

## Conclusion

Confusion reigns as to precisely what role (if any) the FSA's enforcement team will play going forward, but in light of the planned creation of a new agency responsible for tackling economic crime, it would appear that the FSA may never get the chance to fulfil its dream of being "a feared and respected criminal prosecutor". Whether the new agency achieves this goal will depend in large part on whether it manages to secure convictions in relation to insider dealing rings involving big names and large financial institutions. But, the Court of Appeal's forceful message in *McQuoid* will only serve to encourage those responsible for policing the markets to bring more criminal prosecutions, safe in the knowledge that the courts will support it in its fight against insider dealing. In the meantime, assuming it retains responsibility for non-criminal misdemeanours, the FSA's enforcement team will continue to use its regulatory powers to send strong messages to the market that market abuse will not be tolerated.

### Notes

1. www.fsa.gov.uk/pubs/final/bertie_hatcher.pdf
2. www.fsa.gov.uk/pubs/final/john_shevlin.pdf
3. For a detailed discussion of those cases (focussing on the RDC's worrying rejection of the statutory defence to market abuse under *s.123(2)(a)* of FSMA), see the article by the same author in the November 2009 issue of Compliance Monitor. See also, more generally, www.traverssmith.com/assets/pdf/legal_briefings/fsadebtissues.pdf.

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