FSMA: MARKET ABUSE – restrictions on share dealing by an auditor - expert evidence – misuse of information - qualifying investments - information not generally available to those using the market - "based on" - relevant information - failure to observe reasonably expected standard of behaviour - penalty

THE FINANCIAL SERVICES AND MARKETS TRIBUNAL

ARIF MOHAMMED

Applicant

- and -

THE FINANCIAL SERVICES AUTHORITY

Respondent

Tribunal: WILLIAM BLAIR QC (Chairman)
CATHERINE FARQUHARSON
KEITH PALMER

Sitting in London on 7, 8 and 9 March 2005

The Applicant in person

Mr Andrew George, instructed by the Respondent, for the Respondent

DECISION

1. The Applicant, Mr Arif Mohammed, was an audit manager with the accountancy firm PriceWaterhouseCoopers ("PwC"). In summary, the Financial Services Authority ("FSA") contends that the Applicant engaged in market abuse in that he purchased shares in a company called Delta plc ("Delta") at a time when he knew, as a result of confidential information obtained in the course of his employment with PwC, that Delta intended to sell its electrical division, that the sale process was progressing well, and that any sale was likely to be announced shortly. This behaviour the FSA asserts was market abuse within the meaning of s. 118 of the Financial Services and Markets Act 2000 ("FSMA"). By a Decision Notice dated 30 April 2004, the Regulatory Decisions Committee of the FSA decided to impose a penalty of £10,000 on the Applicant.

2. The Applicant has referred the matter to the Tribunal challenging the decision on a number of grounds. In summary, he contends that all he was aware of was a possible sale, that he had none of the details which would have affected the share price, that his purchase of the shares was not in any way influenced by the information which he had, that his audit duties as regards Delta were very limited at the time of the purchase, and that though the purchase breached the independence rules applicable to auditors, his action was not unlawful, and he has not committed an act of market abuse. In the alternative, he contends that the penalty imposed on him is too severe given in particular his financial circumstances.

3. The Tribunal observes at the outset that the Applicant has represented himself before us with skill and moderation. It also observes that uniquely in the case of market abuse allegations, the FSMA provides for a legal assistance scheme available to eligible applicants where the interests of justice require it. This scheme was drawn to the Applicant's attention by the Tribunal at a directions hearing on 25 November 2004. We believe that he was already aware of it, but also think that it would be sensible for FSA procedures to publicise the scheme to those potentially eligible to use it, so far as this is not already done. For example, mention of the scheme could be included where the decision notice explains the right to refer the matter to the Tribunal. At all events, in the present case the Applicant did not apply under the scheme, telling us that he did not satisfy the criteria, since he had been getting financial assistance from his father which formed part of his income albeit on a temporary basis.

The Tribunal's approach

4. This is the first time the market abuse provisions in FSMA have been the subject of a ruling by the Tribunal. The task of the tribunal is to conduct "a *de novo* review of the matters referred to it. It may consider evidence whether or not it was available to the Authority at the material time. It may decide points of law, including disputes about the limits of its own jurisdiction and the lawfulness of the decisions and actions of the Authority" (*R (on the application of Davies and others) v Financial Services Authority* [2004] 1 WLR 185 at [8], per Mummery LJ).

5. The Applicant submits that a market abuse case is akin to a criminal offence, and that the burden is on the FSA to prove its case beyond reasonable doubt. The FSA submits that this is a "balance of probabilities" case, subject to the decisions that this Tribunal has made in relation to what is sometimes described as the "sliding scale", the principle being that the more serious the allegation the more cogent the evidence needs to

be to prove it: see *Hoodless and Blackwell v FSA* ((FS & M Tribunal, 3 October 2003, at [21]), *Legal & General Assurance Soc Ltd v FSA* (FS & M Tribunal, January 2005, at [19]). These, it is true, were not market abuse cases, and the Tribunal recognises that specific considerations arise in such cases, including the fact that (as in the present case) enforcement action may be taken against persons who are not regulated by the FSA. Nevertheless, on the burden of proof point, the Tribunal agrees with the FSA's submission, holding that the "sliding scale" principle applies. The issue may be of limited practical effect, because we proceed on the basis that the allegation made against the Applicant is a serious one attracting potentially serious penalties, and have applied the sliding scale with that in mind.

The evidence before the Tribunal

6. There was extensive disclosure by the FSA in accordance with its duty under rules 5 and 7 of the Financial Services and Markets Rules 2001. The Applicant filed a full written response dated 4 August 2004 to the FSA's Statement of Case, together with supporting documents. We received written and oral evidence from four people from PwC who were concerned with the Delta account in one capacity or another, from the Head of Compliance at PwC, from a witness called by the FSA as an expert in the capacity of a regular user of the market, and from the Applicant himself. All witnesses sought to assist the Tribunal in a careful manner. However, we have not been able to accept that the expert can truly be described as independent. And ultimately, we were unable to accept the evidence of the Applicant on some of the key issues. The facts as we find them are set out in the following paragraphs.

Project Spark

7. The Applicant qualified as a Chartered Accountant in 1994, and joined Coopers & Lybrand (which subsequently merged to become PwC) in 1995, becoming a manager in 2000. As such, he worked in the firm's audit practice based in Birmingham.

8. Delta is an industrial group with operations in a number of countries, whose shares are quoted on the London Stock Exchange. The Applicant was a member of PwC's audit team responsible for auditing the UK part of Delta's electrical division, becoming manager of the team in January 2000. He managed year-end audits for Delta's financial years ending December 1999, 2000 and 2001, as well as interim audits. Delta was one of a dozen or so clients that he had.

9. During the first half of 2002, the Board of Delta decided to dispose of its electrical division. The sale project was codenamed "Project Spark." The evidence of Mr David Watson, a London-based partner of PwC who was responsible for Delta's audit between 1999 and 2002, is that in 2001 the electrical division reported £10.0 million profit before taxation out of a total of £26.1 million reported for the continuing operations of the whole of the Delta group. Its net assets were £109.5 million compared to £298.2 million for the whole of the Delta group. Its turnover was £233.2 million out of a total of the £594.2 million reported for the whole of the Delta group. On any view therefore, this was a major disposal for the company to make.

10. In about June 2002, Delta asked PwC to carry out certain work in order to assist with Project Spark. Mr Watson says that PwC agreed to do some update work for the company, reviewing the results of the electrical division for the first half of 2002, and

following up matters identified during the 2001 audit. It is not in dispute that he spoke to the Applicant on 9 July 2002, telling him of the prospective sale, and explaining to him what work Delta wanted done in connection with it.

11. In an e-mail to the Applicant sent the same day, Mr Watson attached the agreed scope of work with Delta, and said.

> "Can I re-enforce that nobody at the Electrical division is aware of Project Spark (the proposed disposal of the division) except for Mike Galley [the Managing Director of the electrical division]. It must not be discussed with company officials in any circumstances."

The e-mail was copied to Mr Harrold, a Midlands-based PwC partner in charge of managing the audit of the UK-based entities in Delta's electrical division, Mr Watson leaving it to the two of them how they would coordinate the work.

12. The need for secrecy was also referred to in an e-mail sent to the Applicant the same day by Delta's Financial Controller, Mr Mark Luton. In it Mr Luton said, "As David [Watson] has mentioned, this is highly confidential". The Tribunal has no doubt that it was well understood by those who did know about the proposed sale that the information was highly confidential. This included the Applicant who had been told about the need for secrecy in terms, and who in any case as an experienced accountant would have understood this perfectly.

Responsibility for the audit work

13. The agreed work, which was relatively modest in scope, was completed on 7 August 2002. Thereafter in September 2002, there was a change in the Applicant's duties as regards Delta, when Mr Harrold delegated the role of the manager of the audit of the UK-based entities in the electrical division to Mr Edward Cadby. The Applicant says, and the Tribunal accepts, that this was at least is part on his recommendation, and certainly there was no criticism of his performance.

14. Mr Harrold's evidence is that he asked the Applicant to continue with a watching brief over the audit. The Applicant described himself "as assuming a background role on this client" in an e-mail of 18 September 2002. The general point he makes, which again the Tribunal accepts, is that his involvement in ongoing audit work from then on was slight. However he did continue to have a role in relation to the audit particularly as regards the allocation of staff, something that became important later in the year. The Tribunal finds (so far as it may be in dispute) that he remained on the audit team assigned to Delta throughout the relevant period.

What the Applicant knew about the ongoing sale

15. A central argument relied on by the Applicant in resisting the allegation of market abuse made against him, is that he was not involved in the firm's work on the sale, and that he was not aware of what was happening in that regard. All he ever knew about, he argues, was a possible sale. The Tribunal will have to assess the strength of this argument in due course, but first we set out our findings as to the relevant facts.

16. Mr Watson explains in his evidence that Delta approached the sale by soliciting bids from interested parties. There was a shortlist by 9 July 2002, the date on which he sent the e-mail to the Applicant which is quoted above, though the Applicant never saw the short list. A company called Eaton Corporation emerged as the potential purchaser probably some time in September. The PwC witnesses directly concerned in the sale did not give a date, and we infer that PwC was not aware of the precise position in that regard. Information as to the identity of the prospective buyer was kept within a small group within PwC, not including the Applicant.

17. At this point, the work that was being done by PwC in relation to the sale was being done in London, not in Birmingham where the Applicant was based. A principal item related to an information circular to the shareholders about to the sale to be sent out once the sale had been agreed with the prospective buyer. Mr Watson explained that the circular was fundamental since the shareholders were going to have to approve the sale. It involved confirmation by the directors that the company would have sufficient working capital following the disposition of its electrical business, which confirmation PwC would in effect verify. According to Mr Watson, the work preparing it took place in late October, early November. A draft of the working capital report was produced on 21 November 2002. The Applicant had no involvement in this work.

18. The Applicant has identified various other aspects of the sale which featured in the material before the Regulatory Decisions Committee, specifically, the setting up of a data room (to provide potential bidders with information), a "hold harmless" letter which PwC required before giving access to their working papers, a visit to the business by the potential buyer, and the minutes of a board meeting of 21 November 2002 discussing the disposal. He says, and the Tribunal accepts, that he had no involvement in any of this activity.

19. The Applicant also argued that until a sale was finally agreed, nothing was certain. His point is that all he knew about was a *possible* sale. In his closing submissions dated 9 March 2005, he cited the evidence of Mr Priggen, who worked in London coordinating the Delta group audit and reporting directly to Mr Watson. He was directly involved in preparing the working capital report. Asked in cross-examination whether he ever communicated with the Applicant when it became apparent to him that a disposal was imminent, he said that, "Until it is actually announced, I am not sure if I would have been aware that it was imminent. Potentially, on 4th December, when we issued our letters to the management of Delta, I would have thought it would be imminent then. I cannot recollect if I spoke to you on that date."

20. As a matter of fact, Eaton Corporation did agree to the purchase, but Mr Watson testified to the effect that there were several possible scenarios as to how it might have been structured, and that it was not certain that the disposal was going to happen until early December 2002. In general terms, the Tribunal is satisfied that the sale to Eaton was moving ahead throughout this period, though there were issues as to how it was to be structured, and that it might have gone off right up to the last moment.

21. The question then is as to what the Applicant knew about the ongoing sale. There was evidence before the Tribunal in this regard. On 20 September 2002, Mr Watson e-mailed him saying that, "the sales process is moving on, and I suspect that access to our working papers will be requested. Can you make sure they are in shape, please". The Applicant passed this information on to his colleagues as follows, "Could

you please ensure that your audit files are in shape as it is likely that they may be subject to external review." This was clearly a reference to external review by a potential purchaser, as part of due diligence.

22. The following month, he was copied in on an e-mail from Mark Luton sent on 11 October 2002 which reads as follows:

> "Gents, I have just had a chat with John Priggen from PwC London. I have asked him to communicate to the team in Birmingham (Arif is in the loop already but no one else) that the interim audit work that usually takes place in October/November should be cancelled in light of Project Spark. John, you also please communicate to your team covering LVR as well."

23. In the Applicant's e-mailed response of the same day to Mr Priggen, he denied that he was in the loop, saying, "Could you please let me know what is happening as I've not been informed at all". Whilst accepting that he was not in the loop, the Tribunal has no doubt that the cancellation (or as the Applicant in evidence said it should more accurately be described the postponement) of the interim audit in the light of Project Spark was in itself significant.

24. Further, Mark Luton's e-mail continues:

> "The sales pitch for your teams should be that I have a problem with interim work being done before December as I want the end of November balances looked at to lessen the extent of the post year end work in the [first quarter of] 2003. As I am new to this business, this the first time that this approach is being adopted etc etc."

This "cover story", as Mr George for the FSA described it, shows that the sale was proceeding under conditions of secrecy, since it was intended to provide an explanation to Delta staff why the usual audit work at this time of year was not taking place.

25. The Tribunal is satisfied that the Applicant had a reason to know about the progress of the sale because PwC would have to conduct a full year end audit of the electrical division if the sale fell through, which would have significant resource planning implications. This appears from the next paragraph of his e-mailed response to Mr Priggen, where he says that, "We have a number of staff booked for interim during the next few weeks and if we do need to perform the year end audit, this cancellation will cause MAJOR problems at the final". On 14 October 2002, he e-mailed Louise Clay, who was responsible for staff allocation to the effect that the Delta work had to be rescheduled, and the October bookings cancelled.

26. On 14 October, he was asked whether the local management of Delta were aware of the sale, and e-mailed back that "local management are not aware, except John Howard". In cross-examination, the Applicant said that he could not recall how he became aware that John Howard was an insider. It is reasonable to infer, and the Tribunal does infer, that he was told this in response to his request to know what was happening. The e-mail reads as follows:

> "Local management are not aware, except John Howard. … We've been advised to tell local management that the Group FC [ie Mark Luton]

> would prefer us to look at November ytd numbers and therefore would rather we went in December. You should therefore try and book some staff for Mid-December for planning etc in case sale does not go ahead and we need to complete an audit in January 2003."

27. The Applicant has maintained that the timing of the audit work is not material, because work had to be done regardless of whether the disposal happened or not. In cross-examination, he said that the words in his e-mail should have read, "in case the sale does not go ahead or does go ahead". It is correct, and indeed Mr Harrold confirmed, that the staff planning had to be carried out to try to address all situations. On the other hand, whilst there was audit work to do whether or not the sale went ahead, the nature of the work would not be the same. In any case, we are satisfied that the postponement of the audit work from its October slot must have indicated to the Applicant that by then the proposed sale was getting close to agreement, albeit they had to plan to do the work in case it fell through.

28. On 12 November 2002, the Applicant was asked by way of e-mail from a colleague as to whether Delta was going to be a significant fee/cost client in the current year. On 13 November, he replied, "Not sure at the moment, I will find out later this month". He maintained in cross-examination that what he meant by this was that he would find out from Mr Priggen later in the month what the fee for the 2002 year-end audit was going to be. However, when asked that day in a separate enquiry whether "we are any further in terms of whether or not we will have to audit this client at the year end", he e-mailed back on 14 November 2002, "We will not find out until the end of this month. Ed [Cadby] or I will update you as soon as we know". The Tribunal does not accept the Applicant's explanation of these e-mails: we are satisfied that the Applicant expected to find out later in November the position as regards the sale.

29. In fact, the FSA's case is that he was as good as told the position by Mr Priggen, who in cross-examination stated his belief that the Applicant was aware that he was preparing a working capital report for Delta. The Applicant accepted that this would have made the proposed disposal of the electrical division fairly certain, but he denied knowing about the working capital report. Whilst we found Mr Priggen to be a reliable witness, on this issue his recollection was not very specific. On this point, the Tribunal prefers the Applicant's evidence.

30. On his own case, by the end of November the Applicant had heard nothing to suggest that the sale was going ahead. But neither had he heard anything to suggest that it was not going ahead. In his evidence, Mr Harrold said that once a sale process ceases, you tend to find out fairly quickly about it, because you then need to make arrangements for the year-end audit. In the absence of any negative information, he continued to assume that there was a process ongoing.

31. When this was put to the Applicant, he denied that he too continued to assume that there was a process ongoing, saying that no one suggested that the disposal was actually going to happen, and that there was still uncertainty. He totally disagreed with the proposition that by the end of the month he could be pretty certain that a sale would be announced within a reasonably short period of time. However the Tribunal is satisfied from the totality of the evidence, including its assessment of his oral testimony, that although, as he says, he may have known none of the details, at the end of November when he purchased these shares, the Applicant was fully aware that the sale process was

ongoing, and that by then the proposed sale was getting close to agreement. He believed that the process would result in a sale, which it did, a few days later.

The Applicant's dealing in the Delta shares

32. The records of the Applicant's transactions through his broker, Charles Schwab's Frequent Traders Club, show that he dealt frequently in shares over the period 2000-2003. The records also show that he ignored the firm's restrictions on dealing with the shares of its clients. We will need to come back to these points, but for the moment, state the bare facts.

33. On 29 November 2002, the Applicant purchased 15,000 Delta shares at 80p each at a cost of £12,000. On 9 December 2002, Delta announced that it had agreed to sell its electrical division to Eaton Corporation for £130 million conditional on the approval of Delta's shareholders at an Extraordinary General Meeting to be held in January 2003. That day, Delta's share price rose by 19.1%. The next day, 10 December 2002, the Applicant sold his 15,000 Delta shares for 105p each, realising a profit on the transaction of approximately £3,750.

34. On 5 March 2003, the FSA wrote to the Head of Compliance at PwC about the Applicant's dealings in the shares. It asked that no contact should be made with the Applicant in this connection. Up until that time, his account was in the name of himself and his wife. On 10 March 2003, the Applicant wrote to Charles Schwab asking that the account be put into his wife's sole name. He says that this was for tax reasons, but the Tribunal does not accept this explanation, finding that this was an attempt to disguise the dealing.

35. On 12 March 2003, he e-mailed Charles Schwab asking whether the firm would notify an account holder before providing information at the request of the regulatory authorities. In this respect, the Tribunal does accept his explanation, which was that by then he had received a call from an FSA investigator, and wanted to understand what the process would involve.

Applicable restrictions on share dealing by an auditor

36. The Tribunal notes that safeguarding the independence of an audit is an important aspect of good corporate governance. This is recognised both in the Statement of Auditing Standards, and in PwC's own rules. As regards the former, SAS 240 places obligations on audit engagement partners to have in place adequate arrangements to safeguard their objectivity and the firm's independence. The Applicant accepts that he was aware of these standards.

37. He accepts that he was also aware of PwC's internal independence rules. These are described in some detail in the evidence of Ms Janet Haber, who has been Head of Compliance at PwC since July 2003. She explained that PwC has a rule against using confidential information for one's own purposes. More specifically, she explained that in essence, the PwC rules state that:

> "… practice staff, including audit managers, should not purchase interests, including shares, in any entity on PwC's worldwide restricted entity list. In addition PwC staff may not keep such interests if they

already hold them on joining or if they held them before the entity joined the restricted list. There are dispensations available for investments held prior to working for the firm or acquired involuntarily, for example, through marriage or inheritance. However; a dispensation is conditional on the person not working on the audit client concerned. New securities holdings and complete disposals of securities holdings must be reported within fourteen days. These restrictions also apply to employees' spouses or equivalents and their dependents."

38. She went on to explain that:

"The restricted entities list, also known as the independence list, is updated on an ongoing basis and available electronically to PwC member firms on a global basis. The independence list does not include all clients of PwC, but rather those entities with publicly available securities from whom independence (in accordance with PwC's policy) is required. These will largely comprise audit clients of PwC member firms including the UK firm and affiliates of those clients or other related entities where independence is required."

39. The independence list, she said, is a very large electronic list maintained on PwC's database. Employees are required to provide an electronic independence return at least annually as part of the annual confirmation process which is run centrally. In addition, audit engagement partners on listed company audits such as Delta plc are required under the firm's policy relating to Statement of Auditing Standard 240 to seek confirmation from members of the head office and local office engagement teams as to their personal independence.

40. The Tribunal notes therefore that practice staff such as partners and audit managers are prohibited under these rules from purchasing shares in any company which PwC audits, not merely those which they audit themselves.

41. The Tribunal also notes Ms Haber's evidence that although there have been no major changes in relation to the policy on partners or practice staff holding investments in audit clients of the firm for several years, the rules were updated in November 2002. As was explained in the course of the hearing, whereas previously staff had to make declarations in relation to restricted stock, under the firm's new Global Portfolio System ("GPS"), staff concerned had to input their investment portfolio (and that of their spouse etc) which the system would monitor. A note was sent to individuals affected by the policy on 4 October 2002 giving a deadline of 4 November 2002 for partners and managers to record their securities on the GPS. Though the Applicant could not specifically remember, he accepted that he would have received this note, and indeed made a return.

The Applicant's failure to comply with these restrictions

42. The Applicant accepts that he failed to comply with the PwC rules over the relevant period, and not just in relation to Delta. Ms Haber lists nine other stocks on the PwC independence list which the Applicant dealt in. His argument is that though

such trading breached the internal rules, it was not unlawful, and not relevant to the allegation of market abuse, which is what the Tribunal is concerned with here.

43. The Tribunal accepts his argument in this respect in part, but only in part. He is clearly correct to contend that trading in breach of rules or standards does not in itself found an allegation of market abuse. However, the fact that there is such behaviour may be significant, for example, in considering that part of the statutory test that refers to "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". Further, when we come to assess the veracity of the Applicant's evidence, the Tribunal is entitled to, and has, taken into account untruthful statements which the Applicant has made in connection with his share dealing. In other words, it goes to his credibility in relation to other matters.

44. The facts as we find them are, in brief, that in the May 2002 Staff Independence Confirmation which the Applicant returned covering the previous twelve month period, he answered "no" to the question, "have you and/or your dependants held investments in any restricted entity?". This, as he accepted, was untrue. (There was a similar untrue answer in the 2003 Confirmation.) On 4 November 2002, he made the return required under the newly introduced GPS, stating, "no secs [securities] held – own none". Again, he accepted that this was untrue. Indeed, the same day, he had purchased £16,000 worth of Hays shares, sold £16,500 worth of Vodafone shares, and later in the day bought £16,000 worth of Vodafone shares.

45. Most significant, so far as this matter is concerned, is what happened after the sale of the electrical division was made public. It will be recalled that the Applicant had bought Delta shares on 29 November 2002, selling them on 10 December 2002. The following day, 11 December, he and the three other PwC practice staff concerned on the Delta audit received an e-mail headed, Delta Electrical Audit 2002 – SAS 240 Confirmation". By the e-mail, the recipients were asked to "read the following statement to confirm that you are independent with regard to the Delta Electrical Division audit by forwarding this mail back to me". In other words, those responsible for the Delta audit were being expressly asked to confirm their independence following the public announcement of the disposal. The statement reads, "I am aware of the UK, and PwC requirements, have completed the latest compliance return and that nothing has changed since I completed that return. I undertake to notify the engagement partner immediately should there be any change in my personal circumstances". Later on 11 December, the Applicant e-mailed back saying, "I am independent".

46. He manifestly was not independent, and has accepted that this statement was untrue. In his response to the FSA's Statement of Case, the Applicant says that he had tracked Delta for some time, but did not invest in the stock because he had significant direct audit involvement until August 2002. Once this ceased, he states, he felt it was appropriate to purchase the shares. However the Tribunal is satisfied that he knew that it was quite inappropriate for him to purchase the shares. Leaving aside the nature of the information which he had about the disposal, and what motivated his purchase of the shares, this was not only a company on the independence list, but a company which for which he had continuing audit responsibilities.

Market abuse: the statutory test

47. Section 118 FSMA is applicable in this case predates the implementation of the EU Market Abuse Directive (Directive 2003/6/EC). The section categorises three types of behaviour as market abuse, which have been colloquially referred to as the "three m's", being misuse of information, misleading or false impression, and market distortion. In each case, the behaviour concerned must be such as to be likely to be regarded by a regular user of the market as a failure to observe the standard of behaviour reasonably expected of a person in his position in relation to the market. Thus the inquiry is as to the view a regular user of the market would take of the behaviour concerned, rather than into the subjective intention of the actor.

48. This reference is concerned with an allegation of the first kind, namely, misuse of information. Section 118 so far as relevant 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)—
>
> (a) which occurs in relation to qualifying investments traded on a market to which this section applies;
>
> (b) which satisfies any one or more of the conditions set out in subsection 2; and
>
> (c) which is likely to be regarded by a regular user of that market who is aware of the behaviour as a failure on the part of the person or persons concerned to observe the standard of behaviour reasonably expected of a person in his or their position in relation to the market.
>
> (2) The conditions are that—
>
> (a) the behaviour 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 or would be likely to be regarded by him as relevant when deciding the terms on which transactions in investments of the kind in question should be effected;

49. By s. 119, the FSA is under a statutory duty to issue a code giving guidance as to whether or nor behaviour amounts to market abuse. In part, the purpose was to meet concerns as to the potential width of the statutory definition. This has been done in the form of the Code of Market Conduct ("the Code") which forms part of the FSA's handbook. Both parties have relied on provisions of the Code in support of their respective cases.

The market abuse allegation

50. We have summarised in the first and second paragraphs of this decision the FSA's case as put in its written opening submissions, and the Applicant's case as put in his written and oral submissions.

51. At the hearing, Mr George emphasised that whatever the Applicant may have known about the likelihood of a sale, and whether or not he knew that it was imminent when he bought the shares, the FSA's primary case was that once the Applicant had been told that there was a plan to sell the electrical division, particularly since he had been told that the plan was confidential, he became, without

using the word in a technical sense, an 'insider'. He could not, from that moment on, it is submitted, deal in Delta plc shares without committing an act of market abuse. As far as the FSA are concerned, he said, the only circumstances that could release the Applicant from that position was either the sale being announced to the market so that it became public, the receipt of information that the project was over, and there was no longer an intention to proceed with the sale.

The expert evidence

52. As its terms makes clear, an element of FSMA s. 118 is the "regular user of the market" test, which applies in the present context both as regards the relevance of the information allegedly misused, and as regards the standards of behaviour allegedly infringed. In order to show what the views of a regular user of the market would be, the parties were given permission to call expert evidence.

53. Not surprisingly, the Applicant has not called an expert, and as an un-represented party would face obvious difficulties in this regard. The FSA called Mr Andy Brough, who is a fund manager with Schroders plc, and who regularly invests in UK smaller company shares such as Delta. As well as evidence in his capacity as a regular user of the market, Mr Brough also gave certain factual evidence as to as to share movements and rates of return for the Delta shares during the relevant period.

54. Mr Brough says in his report that although instructed by the FSA, he is entirely independent and the opinions provided are his own, recording that Part 35 of the Civil Procedure Rules (CPR) and the Practice Direction for CPR 35 have been made available to him. However he very properly disclosed that the Group Compliance and Risk Director at Schroders was a member of the FSA's Regulatory Decisions Committee ("RDC") and was involved as a member of the RDC in the FSA's decision to discipline the Applicant.

55. Mr Brough says that at no time has he discussed the matter with his Compliance Director. But the Applicant has contended that since both of them are from the same firm, Mr Brough cannot be treated as a truly independent witness. The force of the Applicant's point is that Mr Brough would be naturally reluctant to depart from the findings of the senior compliance officer of his own firm as to the characterisation of the impugned behaviour.

56. For the FSA, Mr George responds that in any regulatory proceedings, as a matter of practical necessity and management discretion, the Authority is very likely to rely upon secondees or contracted advisers from accountancy firms or other financial institutions to assist in investigations. Often, such people will be appointed as statutory investigators. Similarly, in order to improve the quality of its decision-making processes, the FSA invites industry practitioners, who are not employees of the FSA, to sit upon its Regulatory Decisions Committee. If the FSA was to be prevented from instructing experts from any firms, where an employee of that firm had participated in the investigation, it would, given the limited pool of willing and able individuals with true expertise in the various specialist financial services fields considered by the Tribunal, severely restrict the ability of the Tribunal to benefit from appropriate expert evidence.

57. In these circumstances, Mr George submits that there is no relationship between Mr Brough and the FSA which a reasonable observer could think was capable of influencing Mr Brough's views so as to make them unduly favourable to the FSA, drawing our attention to *Liverpool Roman Catholic Archdiocesan Trust v Goldberg* [2001] 1 WLR 2337 (this was the only authority which was cited to us). In summary, he submits that Mr Brough is entirely independent of the FSA.

58. The Tribunal accepts that there is practical force in Mr George's points, and does not wish to place obstacles in the way of finding suitably qualified experts to testify, already no easy task given that they will be drawn from market practitioners, a difficulty which will be faced by other parties too. In any case, the points he makes about investigations do not arise here, so we need not consider them. Furthermore, we accept that Mr Brough has not discussed the matter with his Compliance Direction, that as a fund manager he is well qualified to express a view on the matters in issue, and that he sought to approach the matter independently.

59. The Tribunal also notes that there has been further authority since the *Liverpool* case was decided. The decision was disapproved by the Court of Appeal in *Factortame Ltd v Secretary for the Environment (No 2)* [2003] QB 381 at [67] to [70], per Lord Phillips MR (citing *Field v Leeds City Council* [2000] 1 EGLR 54, CA). These authorities show that the connection of the expert witness to one of the parties goes to the weight to be given to the evidence, rather than to its admissibility, as the Court thought in the *Liverpool* case.

60. The present case differs from the situation where objection is taken to the independence of an expert on the grounds (for example) that he is an employee of one of the parties. Here, the connection of the expert is to one of the members of the Committee that had characterised the Applicant's behaviour as an act of market abuse, but we think that the issue should be approached as going to weight. The Tribunal emphasises that we make no criticism whatever of the witness, but in this particular case, we accept in general terms the points the Applicant has made as regards Mr Brough's independence. Insofar as he has been tendered as an independent expert giving an opinion as to the views of a regular user of the market, we have been unable to give his evidence much weight. The same caveat does not apply to the factual evidence which he gave, such as in relation to share movements, and the information available in brokers' notes, and the like.

The elements of the market abuse allegation

61. We now set out the arguments in respect of the individual elements of the market abuse allegation as they have been put to the Tribunal, and our findings in this regard. In summary, there are a number of things the FSA must prove to make good a case under the relevant part of s. 118, namely, that the Delta shares were qualifying investments, that the Applicant's behaviour in dealing in them was based on information which was not generally available to those using the market, that a regular user of the market would have regarded it as relevant information in respect of the transaction if the information had been available, and that a regular user of the market would have regarded the behaviour as a failure on the Applicant's part to observe a reasonably expected standard of behaviour.

(1) Qualifying investments

62. There is no dispute that shares traded on the London Stock Exchange such as Delta shares are qualifying investments traded on a market to which s. 118 applies: see Financial Services and Markets Act 2000 (Prescribed Markets and Qualifying Investments) Order 2001, Articles 4 and 5; Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, Article 76.

(2) Information not generally available to those using the market

63. By s. 118, to amount to market abuse, the behaviour concerned must be based on information which is not generally available to those using the market. None of the circumstances described in the Code under MAR 1.4.5 in which information is treated as generally available apply here. The Applicant contended however that rumours of the disposal of the electrical division were already widespread when he purchased the shares.

64. He draws attention to the minutes of a Board Meeting of Delta's electrical division on 21 November 2002 which record concern about the level of rumours surrounding the sale. The same point was made by Mr Owens (its managing director) when he was interviewed by the FSA, but neither seems to have been expressed in the context of the effect of the disposal on Delta's share price. In the Tribunal's view, they refer to rumours among Delta's workforce.

65. The Applicant also produced messages posted on the Interactive Investor discussion board, one of which posted on 25 November 2002 describes Delta stock as one to watch. This is a long way from information about an impending disposal. Mr Brough referred to broker's comments on the Factiva service. One from 8 March 2002 says that Delta had hinted that its electrical division could potentially be for sale. But even if accurate, this shows no more than the possibility of a decision to sell.

66. The Tribunal has seen some helpful analyses of the movement of Delta's stock price which assist it in reaching a conclusion on this point. What this shows is that within a pattern of considerable volatility, the trend of the price was downwards from about mid-May 2002, levelling out in October and November. This does not suggest that a disposal was widely rumoured in the market. The price rose in the first week of December, but the most significant jump in both price and volume of trading came with the public announcement of the disposal of the electrical division on 9 December.

67. In any case the Tribunal draws a clear distinction between market rumours and information. The term "information" in this context requires something which is precise in nature. On the totality of the evidence before it, the Tribunal is satisfied that information about the impending sale by Delta of its electrical division did not become generally available to those using the market until the sale was announced.

(3)"based on"

68. To make good its case, the FSA must prove that the Applicant's purchase of the shares was "based on" information which was not generally available to those using the market. What is meant by the words "based on" in s. 118? In the Tribunal's view, they are correctly interpreted in MAR 1.4.4 of the Code, which states that the information concerned must have a "material influence" on the decision to engage in the dealing. It must be one of the reasons for the dealing, but need not be the only reason.

69. The background shown by his account with Charles Schwab's Frequent Traders Club is that the Applicant regularly traded shares, looking for opportunities to make a relatively speedy profit. His share trades were largely for a short-term period, and he often engaged in "day trading".

70. His case is that the limited information that he had about the disposal did not influence his purchase of the Delta shares. He says that he tracked the shares, but did not buy them because he was actively involved in Delta's audit. Once he took a background role in that regard, he bought the shares based on the high dividend yield offered. He made the purchase on 29 November because the share price was increasing, and the dividend yield was being eroded.

71. In a voluntary statement given on 8 August 2003, he said that he acquired the shares in Delta "solely because the rate of return (ie dividend income per cost of each share) had reached 10% during 2002". However on this ratio, he could have acquired the shares at any time between 30 September and 15 October or between 5 November and 28 November, when the share price satisfied this criteria (i.e. 80p or less with a dividend yield of 8p). When this was put to him, he said that liquidity problems precluded purchases within this time. However, this tends to be disproved by the fact that during those periods he purchased, amongst others, on 15 October, £7,500 of shares in ARM Holdings; and, on 13 and 14 November, approximately £53,000 of shares in Corus and Cable & Wireless.

72. The Applicant was not, in the Tribunal's judgment, an investor who bought with a view to dividend yield, and it rejects his explanation of the purchase. The facts speak for themselves. On 29 November, the price of the stock had been relatively flat for a couple of weeks. On that day, he purchased the Delta shares. On 9 December 2002, Delta announced the disposal of its electrical division, and as has been noted the share price rose sharply. The following day, the Applicant sold and took his profit. On the totality of the evidence, including our assessment of his oral testimony on this point, the Tribunal is in no doubt that the Applicant's purchase of the stock was based on the fact that at the end of November he was fully aware that the sale process was ongoing, and that by then the proposed sale was getting close to agreement, albeit it might still fall through.

(4) Relevant information

73. Under s. 118, the information in question must be such that, if available to a regular user of the market, it would or would be likely to be regarded by him as relevant when deciding the terms on which transactions in investments of the kind in question should be effected. In other words, the information in the hands of the "insider" must be such as a regular user of the market would regards as relevant to the terms of the kind of transaction in question.

74. The meaning of "relevant information" is expanded upon in MAR 1.4.9 of the Code as follows:

> "Whether, in a particular case, a particular piece of information would, or would be likely to, be regarded as relevant information by the regular user will depend on the circumstances of the case. In making such a determination, the regular user is likely to consider the extent to which:
> (1) the information is specific and precise;
> (2) the information is material;
> (3) the information is current;
> (4) the information is reliable, including how near the person providing the information is, or appears to be, to the original source of that information and the reliability of that source;
> (5) there is other material information which is already generally available to inform users of the market; and
> (6) the information differs from information which is generally available and can therefore be said to be new or fresh information."

75. A primary plank in the Applicant's argument is that the information in his possession was not "specific and precise". He accepts that he was aware of a possible sale, but says that he did not know until it happened that it would or was likely to happen. He argues that it was the details relating to the disposal that were relevant, cash to be received, terms and conditions, profit to be received by the vendor which would have determined whether the transaction would be favourable to Delta, and therefore result in a rise in the share price. On the basis of the limited information that he had, he argues, there was a high risk that the share price could have decreased.

76. However as the Tribunal has found, at the end of November when he purchased the shares, though he did not have the details of the proposed deal, the Applicant was fully aware that the sale process was ongoing. The Tribunal is satisfied that this information was in itself specific and precise. The Applicant knew what other market users could only guess at, namely that Delta was in fact in the train of selling its electrical division, even if there was always the possibility that the sale might not go ahead, and uncertainty as to how, if it did, it would affect the share price.

77. Mr Brough's evidence was that if the only information in one's possession was that a company was proposing to sell a division, this would be relevant to making an investment decision even without clear information as to timing and financial terms. The Tribunal would have reached this conclusion on the present facts without his evidence, and this is the approach that we have taken. The conclusion seems inescapable when one considers the size of the disposal of the electrical division in the context of the Delta Group as a whole. We refer again to Mr Watson's evidence. In 2001 the electrical division accounted for £10.0 million of a total of £26.1 million pre-tax profit for the Group, its net assets were £109.5 million compared to £298.2 million for the Group, and its turnover was £233.2 million out of a total of the £594.2 million for the Group. The Tribunal is in no doubt that the information which the Applicant had as to the ongoing sale of the electrical division was such that, if available to a regular user of the market, it would or would be likely to be regarded by him as relevant when deciding

the terms on which transactions in investments of the kind in question—in other words purchases of Delta stock—should be effected.

(5) Failure to observe reasonably expected standard of behaviour

78. Finally, the FSA must prove that the Applicant's behaviour in buying the shares is likely to be regarded by a regular user of the market who is aware of it as a failure to observe the standard of behaviour reasonably expected of a person in the Applicant's position in relation to the market.

79. Mr Brough's evidence was that the Applicant had not adhered to the standard expected of him by a regular market user. Again, the Tribunal would have reached this conclusion on the present facts without this evidence, and this is the approach that we have taken. Again the conclusion seems inescapable. The Tribunal refers to the detailed findings set out above as to the standards applicable to the Applicant as auditor, and his manifest failure to comply with them. In summary, as one of the company's audit team, the Applicant was well aware that he should not have been dealing in Delta shares. He knew that the regulatory requirements contained in SAS 240 required Mr Watson, as audit engagement partner, to establish the independence of the audit team. He knew that Mr Watson needed to be able to rely upon his honesty in answering questions about his share dealings in order for PwC to fulfil its regulatory requirements following the public announcement of the disposal of the electrical division. When asked on 12 December 2002 pursuant to SAS 240 to confirm his "independence" from Delta, he gave an untruthful response.

Conclusion as to market abuse

80. For the above reasons, the Tribunal finds that in the circumstances, the Applicant's behaviour in buying Delta shares on 29 November 2002 amounted to market abuse within the meaning of s. 118 FSMA. In the Tribunal's view, the decision of the Regulatory Decisions Committee given on 30 April 2004 was correct in that respect.

Penalty

81. By FSMA s. 123, the consequence of a finding of market abuse is that the FSA may impose a penalty of such amount as it considers appropriate. By FSMA s. 390(9), if unpaid a penalty may be recovered as a debt due to the FSA. Alternatively, the FSA may publish a statement to the effect that the person concerned has engaged in market abuse. These are the only steps that may be taken. Section 123(2) of the Act provides that the FSA may not impose a penalty on a person if (to paraphrase the subsection) he believed, on reasonable grounds, that his behaviour did not amount to market abuse. The Tribunal is satisfied on the basis of the above findings that this provision does not apply to the Applicant.

82. As indicated, the Regulatory Decisions Committee of the FSA decided to impose a penalty of £10,000 on the Applicant. The Applicant's case in this respect has largely turned on his poor financial position. He submits that the penalty is punitive, and was calculated at a time when his financial circumstances were significantly better than they are now. He submits that the FSA are trying to "pigeonhole" the level of fines that they are imposing and are not considering the financial circumstances of the individual

concerned. The consequence of his actions is that he has lost his employment with PwC, and will lose his Chartered Accountant status, which has damaged his earnings potential.

83. The FSA has produced the final notices in six broadly similar cases (that did not result in references to the Tribunal) showing the level of penalty imposed in those cases. Mr George submits that whereas we are dealing here with a complete rehearing on the facts of the case, and the Tribunal will not give and should not give any deference to previous investigations or Regulatory Decisions Committee decisions, once the facts have been found by the Tribunal, in relation to penalty, it may well be more appropriate to give more deference to the policy that the Authority is formulating on quantum of penalty because it is the FSA that has the overall responsibility for securing the statutory objectives set out in FSMA, specifically maintaining market confidence, and protecting the interests of consumers. Whilst acknowledging this point, we do not feel it appropriate to comment on it further in a case where we have only heard submissions on it from one side, but we do observe that the penalty imposed on the Applicant appears to be in line with the penalty imposed by the FSA in similar cases, and we have taken this into account.

84. In his closing submissions, the Applicant gave details of his financial position. In *Piggott v FSA* (FS & M Tribunal, 13 June 2003, at [38]), the Tribunal said that "where ability to pay a financial penalty is in issue, the party raising the issue will be expected to provide detailed evidence as to means, verified where appropriate, bearing in mind that these issues arise in the context of the financial services industry, in which proper attention to such detail is to be expected". Accordingly, following the end of the hearing, the Applicant provided the Tribunal with certain documentation and further information as to his means. The Tribunal was assisted by this further material (which sensibly the FSA has not sought to comment on) and the efficient way in which the Applicant provided it.

85. In summary, it shows that when the Applicant's assets are put against his liabilities, there is a net deficit of £4,252. That assumes that the valuation of his house at £110,000 to £120,000 is accurate, in respect of which there is no supporting material. It also includes the value of the shareholding in a Frequent Traders Club in his wife's name, which we assume is the same account as is referred to above, and particularly in view of our findings in this regard, properly taken into account. This values the shareholding at £63,423. On the other hand, he has substantial debts on his mortgage, on loans and on credit cards. All in all, we are satisfied that the Applicant is in a difficult financial position, but he does have substantial assets, and the shares are readily realisable.

86. ENF 14 of the FSA Handbook ("Sanctions for market abuse") sets out a number of relevant factors taken into account by the Authority in determining the level of financial penalty in a market abuse case: see, in particular, ENF 14.7. One of the factors is the financial resources and other circumstances of the individual concerned, including whether there is verifiable evidence of serious financial hardship or financial difficulties if the individual were to pay the financial penalty that would, in the absence of this consideration, be imposed. A cross-reference is made to ENF 13.3.3, which states that, "The FSA regards these factors as matters to be taken into account in determining the level of a penalty, but not to the extent that there is a direct correlation between those factors and the level of penalty".

87. In assessing the appropriate penalty, the Tribunal has taken account in particular of the deliberate nature of the Applicant's actions, the breach of trust involved in an auditor misusing confidential information provided to him by an audit client, and the fact that he made a profit of £3,750 from the dealing. In mitigation, the Tribunal has taken account in particular of the Applicant's limited means, and the impact that his actions have had, and will have, on his career.

88. The Tribunal is in no doubt that this is an appropriate case for a financial penalty, rather than a published statement. We note from the Warning Notice that the FSA proposed a penalty of £15,000, whereas in the event the Decision Notice imposed a penalty of £10,000, recording that the Applicant's means appear to be modest. We have carefully considered whether this we should reduce the penalty further, but in the light of all the above, we have come to the conclusion that a penalty of £10,000 is the appropriate one.

Decision

89. Accordingly, under section 133(4) of the Financial Services and Markets Act 2000, the Tribunal determines that the appropriate action for the Authority to take in relation to this matter is the imposition of a penalty of £10,000 under section 123(1) of the Act, and under section 133(5) remits the matter to the Financial Services Authority directing that a penalty be imposed in this amount.

90. This decision is unanimous.

WILLIAM BLAIR QC
Chairman

Date: 29 March 2005

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