FINANCIAL PROMOTIONS – approval of non-real time financial promotions for unauthorized overseas persons – whether Applicant was able to show that it had taken reasonable steps to ensure that promotions clear, fair and not misleading – yes – whether Applicant had no reason to doubt that the overseas persons would deal with customers in the UK in an honest and reliable way – yes until mid-November 2003 but no thereafter – whether Applicant arranged for confirmation (that the promotions complied with the rules) to be carried out by an individual with appropriate expertise – yes – whether Applicant conducted its business with due skill, care and diligence – yes - whether penalty of £150,000 excessive – further submissions invited - FSMA 2000 Ss 21, 138 and 206 – Conduct of Business Rules 3.6.1; 3.8.4; 3.12.6; Principles for Businesses, Principle 2

THE FINANCIAL SERVICES AND MARKETS TRIBUNAL

FOX HAYES

Applicant

- and -

THE FINANCIAL SERVICES AUTHORITY

Respondent

Tribunal : DR A N BRICE (Chairman)
MRS C E FARQUHARSON
MISS S C O'NEILL

Sitting in London on 5 to 14 June 2007

Charles Hollander QC, instructed by the Applicant, for the Applicant

Richard Coleman, Counsel, instructed by the Financial Services Authority, for the Authority

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DECISION

The reference

1. Between February 2003 and June 2004 Fox Hayes (the Applicant) approved a number of financial promotions for unauthorized overseas companies. The financial promotions took the form of letters approved by the Applicant and sent by the overseas companies to private investors in the United Kingdom. Each letter offered a free research report into a company in which the investor already held shares. The Applicant also approved the research reports which were later sent by the overseas companies to the investors who requested them.

2. The Financial Services Authority (the Authority) was of the view that the Applicant had not taken reasonable steps to ensure that the financial promotions were clear, fair and not misleading and was also of the view that the Applicant had reason to doubt that the overseas companies would deal with customers in the United Kingdom in an honest and reliable way. The Authority therefore decided to impose a penalty on the Applicant of £150,000 and gave a decision notice to that effect on 29 September 2006. The Applicant referred that decision notice to the Tribunal.

3 In its statement of case the Authority also argued that the Applicant had not arranged for the confirmation exercises (that the financial promotions complied with the rules) to be carried out by an individual with appropriate expertise and that the Applicant had not conducted its business with due skill, care and diligence. The Applicant accepted that, following the decision of the Tribunal in *Philippe Jabre v The Financial Services Authority* (Decision 035), the Tribunal had jurisdiction to consider these matters even though they had not been mentioned in the decision notice.

4. The Applicant disputed all the arguments of the Authority and was also of the view that the amount of the penalty was excessive.

The legislation

The 2000 Act

5. The legislation dealing with financial promotions, the Authority's rule-making power and the imposition of penalties is found in sections 21, 138 and 206 of the Financial Services and Markets Act 2000 (the 2000 Act).

6. Section 21 provides that a person must not, in the course of business, communicate an invitation or inducement to engage in investment activity unless he is an authorised person or unless the content of the communication is approved by an authorised person. An investment activity includes selling securities and giving investment advice. Where a communication originates outside the United Kingdom, the section only applies if the communication is capable of having an effect in the United Kingdom. At the relevant time the Applicant was an authorised person.

7. Section 138(1) gives the Authority power to make such rules applying to authorised persons as appear to be necessary or expedient for the purpose of protecting the interests of consumers. Under this provision the Authority has made the Conduct of Business Rules and the Principles for Businesses.

8. The penalty was imposed under the provisions of section 206 the relevant part of which provides:

> **"(1) If the Authority considers that an authorized person has contravened a requirement imposed on him by or under this Act … it may impose on him a penalty, in respect of the contravention, of such amount as it considers appropriate."**

The Conduct of Business Rules

9. Chapter 3 of the Conduct of Business Rules applies to every firm which communicates or approves financial promotions. This reference concerns non-real time financial promotions. At the relevant time, real-time financial promotions were defined in rule 3.5.5R1 as "promotions which are communicated in the course of a personal visit, telephone conversation or other interactive dialogue". Non-real time financial promotions were defined in rule 3.5.5R2 as "financial promotions which are not real time" and the examples given included promotions made by letter.

10. Rule 3.6 concerns confirmation of compliance and at the relevant time rules 3.6.1R1 and 3.6.1R2 provided:

> **"3.6.1R**
> **1. Before a firm communicates or approves a non-real time financial promotion, it must confirm that the financial promotion complies with the rules in this chapter.**
>
> **2. A firm must arrange for the confirmation exercise in (1) to be carried out by an individual or individuals with appropriate expertise."**

11. Rule 3.8 concerns the form and content of financial promotions and rules 3.8.2R to 3.8.20R apply to firms which communicate or approve non-real time financial promotions. At the relevant time rule 3.8.4R1 provided:

> **"3.8.4R.1 A firm must be able to show that it has taken reasonable steps to ensure that a non real-time financial promotion is clear, fair and not misleading."**

12. Rule 3.12 concerns the communication and approval of financial promotions for an overseas person or unauthorized person. At the relevant time rule 3.12.6R applied to specific non-real time financial promotions for overseas persons and the relevant part provided:

> **"3.12.6R**
> **A firm must not communicate or approve a specific non-real time financial promotion which relates to an investment or service of an overseas person, unless …**
>
> > **(2) the firm has no reason to doubt that the overseas person will deal with customers in the United Kingdom in an honest and reliable way."**

The Principles for Businesses

13. Principle 2 of the Principles for Businesses provides;

> **"2. A firm must conduct its business with due skill, care and diligence."**

The issues

14. Thus what we had to decide was:

(1) whether the Applicant had taken reasonable steps to ensure that the promotions were clear, fair and not misleading within the meaning of COB rule 3.8.4R1;

(2) whether the Applicant had no reason to doubt that the overseas persons would deal with customers in the United Kingdom in an honest and reliable way within the meaning of COB rule 3.12.6R(2);

(3) whether the Applicant had arranged for the confirmation exercises (that the promotions complied with the rules) to be carried out by an individual with appropriate expertise within the meaning of COB rule 3.6.1R2;

(4) whether the Applicant had conducted its business with due skill, care and diligence within the meaning of Principle 2; and .

(5) whether the amount of the penalty was excessive.

The evidence

15. Eleven bundles of documents were produced by the parties.

16. Oral evidence was given on behalf of the Applicant by two partners in the Applicant, namely Mr Robert Manning and Mr Malcolm Jones. We found Mr Jones to be a credible and reliable witness and accept his evidence. We also formed the view that Mr Jones is a competent, careful, honest and conscientious solicitor. We consider Mr Manning's evidence below.

17. Oral evidence was given on behalf of the Authority by Mr Dominic Clark, a Manager in the Small Firms Division of the Retail Markets Division of the Authority and by Ms Verity Elizabeth Casey, the executive assistant to the Managing Director of Regulatory Services at the Authority. Written statements by six other witnesses employed by the Authority were also produced. These were: Ms Susan Cooper, Ms Nausicaa Delfas, Ms Tazeen Mirza, Ms Melanie Jane Ramsay, Ms Kelly Rouse and Mr Peter Willsher. Oral evidence was also given on behalf of the Authority by seven investors who had purchased shares from overseas companies who were clients of the Applicant. Written statements by three other investors, containing evidence on behalf of the Authority, were also produced.

The facts

18. From the evidence before us we find the following facts.

The Applicant

19. The Applicant is a firm of solicitors based in Leeds. After the date of the decision notice the Applicant transferred its business to a limited liability partnership known as Fox Hayes LLP.

20. At the relevant time the Applicant had ten partners including Mr Manning and Mr Jones. Mr Manning had been with the firm throughout his professional life. At the relevant time he was the senior partner and specialized in company and commercial work. He was also the managing partner until about 1998. Mr Manning had by far the

largest capital account of all the partners. He and three other partners constituted an Executive Committee that ran the firm. Each of those four was entitled to a share of the profits. The other partners received a fixed amount each year and sometimes a bonus.

21. Mr Jones was also a partner in the Applicant but he was not a member of the Executive Committee nor was he one of the four profit-sharing partners. He qualified as a solicitor in 1982 and joined the Applicant in 2001. He was the Applicant's compliance officer and also a member of the Committee of the Leeds Law Society. He undertook mostly company and commercial work and his clients were mainly small and medium-sized businesses.

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2000 - The Entrepreneurs Club

22. In about 2000 the Applicant decided to bring potential investors into contact with unquoted companies wishing to raise capital and so established the Entrepreneurs Club. The Club used to circulate promotions for such companies to a list of investors who were either existing clients of the Applicant or were persons who had asked to be included on the list. Every two months the Club held a meeting where companies made presentations to the investors about their business plans. If an investor wished to invest in a company a formal investment agreement was signed; the Applicant would act for the company and not for the investor.

23. Mr Jones looked after the financial promotions and in this way gained experience in approving financial promotions for United Kingdom companies. He became aware of the provisions of the 2000 Act and of the Financial Services and Markets Act 2000 (Financial Promotions) Order 2001 SI 2001 No. 1335 (the Financial Promotions Order) and the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 SI 2001 No. 544 (the Regulated Activities Order). It is also likely that he read a paper entitled "The FSA's Approach to Financial Promotions" which was published by the Authority in 2002.

The OTC Bulletin Board

24. In about 1999 Mr Manning started to advise United Kingdom companies who wished their shares to be quoted on the OTC Bulletin Board in the United States. The operation of the OTC Bulletin Board is approved by the Securities and Exchange Commission of the United States. It is managed by The Nasdaq Stock Market, Inc and is a regulated quotation service which displays real-time quotes, last-sale prices and volume information about over-the-counter equity securities. Only market makers can apply to quote securities on the OTC Bulletin Board and issuers contact an authorized market maker for sponsorship of a security on the service. Issuers of all securities quoted on the OTC Bulletin Board are subject to periodic filing requirements with the Securities and Exchange Commission or other regulatory authority. Shares quoted on the OTC Bulletin Board are generally of smaller companies and are regarded as higher-risk investments than shares listed on the main NASDAQ exchange.

2002 - Mr Manning meets Mr Reade

25. In dealing with these matters Mr Manning came into contact with the New York law firm of Piper Rudnick (now DLA Piper Rudnick) and met Mr Paul Pollock who was then one of that firm's partners. Mr Pollock introduced Mr Manning to a Mr Jeffrey Reade as someone who might be able to assist in providing finance for United Kingdom companies that were attempting to have their shares quoted on the OTC Bulletin Board.

In 2002 Mr Reade invited Mr Manning to visit him in Spain. During that visit various business opportunities were discussed and Mr Reade told Mr Manning that he provided finance to companies wishing to float on the OTC Bulletin Board in return for which he became entitled to 35% of the shares of the companies. When the shares were trading he instructed brokers to sell the shares on his behalf. During the 2002 visit Mr Manning was introduced to a Mr David Rycott who worked for A Street Capital Inc (A Street Capital) one of Mr Reade's companies.

Early January 2003 – Mr Rycott visits the Applicant

26. In early January 2003 Mr Rycott visited the Applicant in Leeds to discuss a proposal for introducing business to the Applicant and met Mr Manning and Mr Jones. We saw a note prepared by Mr Rycott prior to the meeting which summarized the matters he wanted to discuss and which mentioned section 21 of the 2000 Act and the provisions of the Regulated Activities Order.

27. The background to Mr Rycott's proposal was that A Street Capital owned or controlled shares in a number of OTC Bulletin Board companies. Mr Rycott wanted to approach overseas companies who would contact investors in the United Kingdom in order to sell the OTC Bulletin Board shares to the investors. The overseas companies would receive a commission on the shares they sold. Mr Rycott appreciated that, if the overseas companies were unauthorized, then it would be necessary to have an authorized person to approve any promotions under section 21.

28. The proposal, therefore, was that Mr Rycott would introduce the overseas companies to the Applicant who would undertake due diligence on them and make sure that their promotions were fair and not misleading. Typically, an overseas company would write to a United Kingdom investor offering a free research report about a United Kingdom company in which the investor already held shares. By returning the request for a research report the investor would agree to be contacted by the overseas company and told about other investment opportunities. If the investor so agreed, then he would be contacted by the overseas company direct and told about the OTC Bulletin Board shares. Mr Rycott explained that the typical investor would be someone working in the City who had just received a large bonus and wanted a more exciting investment. An investment of about £2,000 would be typical. If an investor agreed to buy shares he would be invited to send the purchase money to the Applicant who would place it in an escrow account. The share certificate would be delivered to the Applicant who would send it to the investor after which the Applicant would account for the purchase money as directed by the overseas company.

29. The phrase "escrow account" was used widely in the documentation we saw and throughout the hearing and so we adopt that usage. In fact, the account was operated as part of the Applicant's client account. It later emerged that in fact it was a company called Bonham Investments Limited (Bonham), which was associated with A Street Capital, who had contractual agreements with OTC Bulletin Board companies to purchase their shares and that it was these shares which were to be sold by the overseas companies to investors. The administrative arrangements for the provision of the share certificates to investors were undertaken by a Mr Anthony May of Zetland European Administration Limited (Zetland) in Geneva who acted for Bonham. When shares had been sold Mr May, through Zetland, ordered the share certificates and arranged for them to be delivered to the Applicant for onward delivery to the United Kingdom investors.

30. It was known by the Applicant from the outset that the OTC Bulletin Board shares to be offered to investors were subject to Regulation S under the United States Securities Act of 1933 which meant that they could not be sold within twelve months and that there were further restrictions on transfer during the twelve months after that.

Mr Jones researches the rules

31. After the meeting with Mr Rycott, Mr Jones looked into the regulatory requirements. He knew that financial promotions had to be clear, fair and not misleading and should be approved by someone who had the appropriate expertise. He also knew that, if acting for an overseas person, a firm should have no reason to doubt that the overseas person would deal with customers in the United Kingdom in an honest and reliable way.

32. On 13 January 2003 Mr Jones prepared an internal note about the requirements for the approval of financial promotions. The note set out a number of steps to be taken by the Applicant for the approval of the sender of the promotions, of the business, and of the promotion. Under the heading of the approval of business, Mr Jones noted that two references should be taken up, one of which should be from a professional person acting for the business; also a note was made that "we will check the FSA "black list"". The reference to the "FSA blacklist" was included because Mr Rycott had mentioned that there was a blacklist. Under the heading of the approval of promotion Mr Jones noted that it had to be clear, fair and not misleading and that statements of fact should be verifiable from an independent source.

33. Also on 13 January 2003 Mr Jones telephoned the Authority and explained the steps he proposed to take. He was reassured that, if he followed those steps, he would be complying with the rules. We accept the evidence of Mr Jones that he was told that he would be doing "more than most" and that he repeated those words to Mr Manning. We also accept that Mr Jones formed the impression that the person to whom he spoke at the Authority would have preferred the rules to be such that the Authority could regulate the overseas sellers of the shares. We also accept the evidence of Mr Jones that if the Authority had told him that something was clearly wrong then the Applicant would not have done it.

34 On the next day, 14 January 2003, Mr Manning wrote to Mr Rycott and sent him two draft letters which would be sent by the Applicant to any unauthorized overseas company who became a client of the Applicant. The draft letters set out the basis on which the Applicant would act in approving financial promotions and in operating the escrow account. In approving financial promotions the Applicant was to be remunerated by reference to the time spent on the work. Thereafter it was Mr Jones who had the day-to-day involvement with the financial promotions and the escrow account, assisted by other staff of the Applicant. On occasion Mr Jones discussed some matters with Mr Manning.

Late January 2003 - Condor Research SL

35. Later in January 2003 the Applicant received instructions from Condor Research SL of Spain (Condor), the first overseas company to be introduced to the Applicant by Mr Rycott. In all the transactions that followed it was, of course, the overseas

companies who were the clients of the Applicant and who gave instructions to the Applicant. The investors were not the Applicant's clients.

36. We describe the first promotion for Condor in some detail because subsequent promotions, both for Condor and the other overseas companies, followed a similar pattern. The work done for the overseas companies was usually done in four stages. First, Mr Jones made enquiries into the overseas company and its business; these enquiries were, of course, only necessary when the Applicant received instructions from an overseas company for the first time. Next Mr Jones approved a letter to be sent by the overseas company to individual investors in the United Kingdom offering a free research report into a United Kingdom quoted company in which the investors already held shares. Later he approved a free research report into the United Kingdom quoted company. After that the overseas company communicated directly with the investors on the telephone about the OTC Bulletin Board shares. Some investors agreed to buy shares. If an investor did agree to buy then the overseas company informed Mr Jones. Mr Jones wrote to the investor with details about the payment of the purchase price into the escrow account which the Applicant operated on behalf of the overseas companies. We now give some further details about each of these four stages by reference to the facts of the first transaction for Condor.

Stage 1 - The enquiries into Condor

37. On 22 January 2003 Mr Jones wrote to Condor saying that the Applicant would act on their behalf in relation to financial promotions. The letter said that, before any financial promotions could be authorized the Applicant would need to satisfy itself about the identity of Condor and that Condor would deal with private customers in the United Kingdom in an honest and reliable way. A copy of Mr Jones' note of 13 January 2003 about the requirements for approval of financial promotions was sent to Condor. The letter went on to state that any financial promotion had to be clear, fair and not misleading and comply with other regulatory provisions.

38. Condor replied and sent some information. This included a company search report showing that the company had been registered on 14 August 2001 and that its principal or sole administrator was Mr Maurice Horsten; the passport and driving licence of Mr Horsten; a tax identification card for Condor; and certain documents in Spanish. Mr Jones did not speak Spanish and so he sent an email to his colleagues to see if any could assist. A colleague was able to assist and sent a note to Mr Jones describing the documents. These were (1) a certificate dated 22 January 2003 that Condor was a properly incorporated company engaging in financial services; that Mr Horsten, the manager, had exercised these duties for four years through other companies in compliance with the requisite law and that the registered office of Condor was in Marbella; (2) a document about the constitution of Condor given on 14 August 2001 in Marbella before a notary stating that the directors of the company were Mr Horsten and a named lawyer and that the share capital was 3,006 shares of one euro each of which Mr Horsten had contributed 3005 euros and the named lawyer one euro; and that the sole management of the company was with Mr Horsten; (3) a certificate attesting Mr Horsten's solvency and his competence to fulfil his obligations; and (4) a certificate attesting Condor's solvency and ability to fulfil its obligations.

39. Mr Jones asked his colleague to translate into Spanish a letter to be sent to the referees named for Condor but no letter was in fact sent.

Stage 2 - The approval of the letter offering the research report

40. On 21 February 2003 Mr Jones approved three documents to be sent by Condor to private investors in the United Kingdom. The details of the investors were obtained by Condor from the share register of a United Kingdom company called Premier Oil plc (Premier Oil). The three documents consisted of a letter from Condor to the investor, a response form and a document entitled Approval, Risks Warning and Additional Terms and Conditions (terms and conditions).

41. *The letter* offered the investor a free research report into Premier Oil, a company in which he already held shares. The letter stated that Condor would use their experience and resources to prepare reports to assist clients in making their own investment decisions. It stated that Condor was not registered in the United Kingdom and was not authorized by the Financial Services Authority. The letter concluded that if the investor wanted the free report he should complete an enclosed response form and return it to Condor.

42. *The response form* was intended to be completed by an investor and began by asking for a copy of the free independent research report "with no obligation whatsoever". It then had spaces for the investor to complete his name, address and telephone number and included the following statement above space for the signature of the investor:

> "I would also like to hear about the services you provide to private investors and I hereby consent to further communications from Condor Research SL [delete if inapplicable].
>
> I have read the Approval, Risks Warning and Additional Terms attached and understand that requesting the report places me under no obligation to transact business with yourselves."

43. *The terms and conditions* started by saying that the documents were issued by Condor and had been approved by the Applicant. Condor was a Spanish company and the Applicant was a firm of English solicitors authorized by the Authority. The rules made under the 2000 Act for the protection of private customers did not apply in respect of any communication from Condor. The investor should seek advice from his own advisers before entering into any transaction. Nothing in the documents amounted to a personal recommendation to any one investor. Condor had the right (with the consent of the investor) to contact him with details of the services they provided to private investors. Condor did not hold any stock positions but might receive commission on selected stock from the services advertised in subsequent communications. Condor provided opportunities for clients to invest in companies which were not quoted in the United Kingdom. If an investor did invest in any such company as a result of a recommendation by Condor then, on the realization of that investment, Condor was entitled to 15% of the profit. The terms and conditions also contained a paragraph in bold type about the value of investments going down as well as up and stated that the deduction of charges and expenses meant that an investor might not get back the amount he invested.

44. When approving these letters, response forms and terms and conditions, Mr Jones normally inserted a manuscript note on each page stating that they had been approved, giving the date, and applying a stamp of the Applicant's name and address. Any errors were corrected and if Mr Jones had a query he would write or send an email to the overseas company.

45. After approval by Mr Jones, Condor sent copies of the letter, the response form and the terms and conditions to United Kingdom investors in Premier Oil. A number of them returned the response form to Condor asking for a free copy of the research report about Premier Oil.

Stage 3 –The approval of the research report

46. On 28 February 2003 Mr Jones approved the research report on Premier Oil. One of the research reports we saw contained a statement at the end that the report was issued by a named overseas company of Spain and approved by the Applicant. The statement added that the overseas company was not regulated in the United Kingdom; that the rules made under the 2000 Act for the protection of private customers did not apply; that no complaints procedure or compensation under the Financial Services Compensation Scheme was available; and that the Applicant was a firm of solicitors authorized by the Authority to approve financial promotions.

47. When approving research reports Mr Jones verified the facts in them and suggested any necessary drafting amendments. He checked the factual information from another source, usually from the website of the company the subject of the report. He also visited other websites to check facts. In some cases he would ask the overseas companies direct where they got their facts from and they would give him a reference which he would check from an independent source. As with the letters, he inserted a manuscript note on each report stating that it was approved, with the date, and the stamp of the Applicant's name and address. If Mr Jones had a query he would write or send an email to the overseas company. (In one case, in April 2004, he informed the overseas company (Tresaderns & Partners SL) that the shares in the company the subject of the research report had been suspended and the business sold and that a shareholders' action group was seeking to take the directors to court. The overseas company decided not to proceed with that report.)

48. Condor then sent the free research report about Premier Oil to the investors in that company who had asked for it. Such investors would also receive one or more telephone calls from Condor suggesting that they might like to buy shares in a company or companies listed on the OTC Bulletin Board. The Applicant was not involved with the telephone calls.

Stage 4 - the operation of the escrow account

49. Once a sale of shares had been agreed by Condor with an investor over the telephone, the Applicant was informed by Condor and wrote direct to the investor about sending the purchase money to the escrow account held by the Applicant for its clients, the overseas companies. The letter from the Applicant to the investor enclosed two documents, one called investment details and one called investor details.

50. *The letter*, which was headed "Proposed Investment", stated that the Applicant acted for Condor and understood that the investor was a client of Condor and wished to

invest in the shares referred to in the investment details. The letter continued by stating that, to ensure that the investor did not part with his money without receiving the share certificate, Condor had asked the Applicant to act in the matter. The investor was asked, if he wished to proceed, to sign and return the investment details form and the investor details form after which the Applicant would send its bank details to the investor so that he could transfer the money direct to the Applicant's bank. The letter went on to say that the Applicant would pay any money received from the investor into a separate client escrow account and the Applicant undertook that the money would not leave that account until the Applicant had sent a share certificate to the investor showing the shares registered in his name. The share certificate would be sent to the investor within three months of the date of the receipt of cleared funds but, if that were not possible, the money would be returned to the investor. (In March 2004 the period of three months was extended to four months in respect of shares purchased from Tresaderns & Partners SL. Mr Jones ensured that the alteration took effect only in respect of shares purchased after that date or in respect of shares purchased earlier if the investor consented.)

51. *The investment details form* gave the name and address of the investor, the details of the proposed investment with the name of the company and the number of shares to be purchased, and a number of notes as follows:

> **"Notes**
> 1. The Shares are quoted on the NASDAQ OTC market.
>
> 2. Fox Hayes, Solicitors, are not advising on the suitability of the above investment. We advise that investors seek independent advice on any proposed investment before sending their money to us.
>
> 3. There is no guarantee that the Shares will increase in value or that anyone will be willing to buy them when you are wanting to sell.
>
> 4. The Shares can only be sold or transferred in accordance with the constitution of the issuing company and the law of the state in which the Company was incorporated. In particular the Shares cannot be sold at all for 12 months from the date on which they are issued.
>
> 5. Please note that the exact number of shares you receive may vary from the above figure to reflect changes in exchange rates."

52. The investment details form concluded with a statement that the investor confirmed that the information in it was correct and that he had read and understood the notes.

53. *The investor details form* asked for the name, address and telephone number of the investor, copies of identity documents and the source of the money being used for the investment. It concluded with the following declaration:

> **"Declaration**
> I declare that:

1. The above information as to my identity is true and accurate and that the copy documents supplied to confirm my identity are accurate

2. The money I am using for the investment is from a legal source.

3. I acknowledge that Fox Hayes, Solicitors,
- have not given any advice to me about the proposed investment;
- are not responsible for supplying the proposed investment to me.

4. I have taken independent advice about the investment from a suitable qualified person or I consider I am sufficiently experienced in investment matters to form my own judgment as to the suitability of the proposed investment for my needs.

5. I have read and understand the notes on the Investment Details.

6. I am not a citizen of, nor resident in, the United States of America.

7. I am of sufficient financial standing to bear the risk of losing my investment in the Shares.

8. I am aware of and understand the risks of dealing in shares in smaller quoted companies. **I accept that the purchase of the shares is a speculative investment carrying a high degree of risk with no assurance of any income or capital return."** [This latter sentence was printed in bold type on the form.]

54. After receiving the letter from the Applicant, and if the investor wished to proceed with the purchase of the shares, he signed both the investment details and the investor details forms and returned both to the Applicant. The Applicant then sent the investor details of its client bank account and the investor made a direct transfer of the purchase price of the shares into that account. The money remained there until the share certificate was received by the Applicant. Once the investor had received the share certificate the Applicant accounted for the purchase money as directed by its clients, the overseas companies. Some investors who received the "Proposed Investment" letter did not return the forms to the Applicant; others returned the forms and sent the money but later asked for a refund. About 20% of all deals were either cancelled or the money was refunded.

55. The overseas companies had an arrangement with Zetland that the money would be sent to Zetland who would account to the owners of the OTC Bulletin Board shares for the price of the shares and who would also account to the overseas companies for the commission due to them on the sale of the shares. Initially the money was sent to an account managed by Mr Pollock of New York. Later it was sent to Rosenman & Colin LLP. On 17 November 2003 this arrangement ceased and after that the money was sent to a firm called EuroNet in Zagreb, Croatia. In 2004 the Applicant was instructed to send the money to ABN AMRO in Holland.

The other promotions and the other overseas companies

56. After the approval for Condor of the initial letters and the research report about Premier Oil, the Applicant approved a number of other promotions for Condor and later

did similar work for four other overseas companies introduced by A Street Capital. These other overseas companies were: Tresaderns & Partners SL of Madrid, (Tresaderns); Benjamin Fisher of Madrid; Universal Market Strategies SL (UMS) of Spain; and Rosenhof Financial Solutions (Rosenhof) of Cape Town, South Africa. On each occasion Mr Jones followed a procedure similar to that we have outlined above.

The enquiries into the other overseas companies

57. We have already described the enquiries made by the Applicant into Condor. In addition, Mr Jones frequently spoke to Mr Horsten on the telephone. In October 2003 Condor ceased trading and after that date Mr Horsten and a colleague (Mr Dimond) operated instead through UMS which was then a newly formed Spanish company. At that time Mr Horsten provided Mr Jones with updated information about himself and Mr Dimond.

58. The Applicant sent Tresaderns an engagement letter on 7 March 2003 with the note about requirements for approval of financial promotions as prepared by Mr Jones on 13 January 2003. In reply were received (1) a company search report that said that the company was registered on 4 February 2003 and that its principal activity was advertising; (2) a passport for Daniel Tresadern valid from March 1999 to March 2004 which stated that he was twenty-eight years old and of British nationality; (3) a tax identification card for the company; (4) a document in Spanish which appeared to be a constitution prepared by a notary in February 2003; (5) a certificate dated 12 March 2003 which appeared to state that Tresaderns supplied marketing services and (6) a further certificate in Spanish about Tresaderns. We accept the evidence of Mr Jones that when these documents arrived he discussed the Spanish documents with a colleague who told Mr Jones what they were about. The Applicant also obtained a search report about Tresaderns from the London Law Agency Limited which indicated that it was a new company and that its principal activity was advertising. An associated company was Walker Stone. We did not see references for the individuals who worked for Tresaderns but accept the evidence of Mr Jones that copies were sent to the Authority (and later mislaid) and that the copies of the originals which were stored in the Applicant's computer had become unreadable. Mr Jones also spoke to Mr Frolik of Tresaderns on the telephone.

59. The Applicant sent Benjamin Fisher an engagement letter on 4 June 2003 with the note about requirements for approval of financial promotions as prepared by Mr Jones on 13 January 2003. In reply the Applicant received information much of which was in Spanish. The documents included (1) a credit report on a company called Diosa Xilon SL which named a Mr Gary Baldock as the sole administrator and which appeared to describe its activity as marketing and public opinion research; (2) corporate and administrative documents for Diosa Xilon; (3) an administrative document which stated that Diosa Xilon had changed its name to Benjamin Fisher; (4) an administrative document that described Benjamin Fisher's business as marketing; (5) a certificate by Mr Baldock in Spanish about the company; (6) a financial statement in Spanish; (7) a formal notarised document about the company; (8) a passport for Gary Baldock which showed that he was thirty-three years old and of British nationality; (9) a reference from a police officer which stated that he had known Mr Baldock for ten years as a social friend and that he had found him to be reliable and trustworthy; and (10) a reference from Mr Baldock's family doctor who had known Mr Baldock for twenty years and stated that he was honest, reliable, and trustworthy. On 16 July 2003 the Applicant

asked for details of the qualifications and experience of the staff and Benjamin Fisher replied "What qualifications are you referring to?" but this was not followed up by the Applicant. Mr Jones thought that a member of staff at Benjamin Fisher had the right qualifications but there was no document to support that. Mr Frolik and a Mr Ian Hughes of Tresaderns were also connected with Benjamin Fisher.

60. The Applicant sent Rosenhof an engagement letter on 10 October 2003 with the note about requirements for approval of financial promotions as prepared by Mr Jones on 13 January 2003. In reply the Applicant received: (1) a company search which showed that Rosenhof was incorporated on 10 September 2002 and that Mr David Hamburger was its director; (2) a copy of Mr Hamburger's passport showing that he was thirty-two years old and of South African nationality; and (3) a reference from a partner in a firm of chartered accountants in New Zealand saying that Mr Hamburger had acted at all times professionally and was honest and intelligent. Mr Hamburger had some difficulty in providing a second personal reference as two of his referees felt that they were not in a position to give a reference. Mr Jones then spoke on the telephone to a lawyer in New Zealand who said he knew Mr Hamburger and had nothing to say against him but was not prepared to give a written reference.

A summary of all the promotions

61. In total, the dates of the promotions approved by the Appellant, the names of their clients, and the United Kingdom companies the subject of the research reports were:

Date	*Client*	*Company*
February 2003	Condor	Premier Oil plc
March 2003	Tresaderns	Emerald Energy plc
May 2003	Condor	Vodafone plc
August 2003	Benjamin Fisher	Signet Group plc
September 2003	Condor	Desire Petroleum plc
September 2003	Tresaderns	Trafficmaster plc
October 2003	Benjamin Fisher	Screen plc
October 2003	Tresaderns	Pacific Media plc.
October 2003	Benjamin Fisher	Universal Direct plc
November 2003	UMS	Desire Petroleum plc
December 2003	Benjamin Fisher	Genus plc.
January 2004	Benjamin Fisher	Torotrak plc
February 2004	Benjamin Fisher	Chorion plc
March 2004	Tresaderns	Artisan (UK) plc
March 2004	Rosenhof	Desire Petroleum plc
April 2004	Tresaderns	Surgical Innovations Group plc
May 2004	Benjamin Fisher	Eckoh Technologies plc
June 2004	Benjamin Fisher	Tandem Group plc
June 2004	UMS	Rank Group plc
June 2004	Tresaderns	Reflec plc

62. The total number of share transactions of each of the overseas companies and the number of investors who purchased shares were:

Client	*Number of deals*	*Number of investors*

Condor	136	62
UMS	27	21
Tresaderns	1,187	362
Benjamin Fisher	570	225
Rosenhof	0	0
Total	1,920	670

63. The total value of the amount of purchase money received by the Applicant for each client was:

Client	*Amount*
Condor	$ 841,568.11
UMS	$ 127,108.91
Tresaderns	$13,311,155.13
Bemjamin Fisher	$ 6,071,154.68
Rosenhof	0
Total	$20,350,986.83

Later developments

64. In the months that followed the approval of the first promotion for Condor Mr Jones attended a seminar given by the Authority and read some press releases about financial promotions published by the Authority. He also received a visit from the Authority. In addition he received correspondence from the press and became aware that the Spanish regulatory authority, the Comisión Nacional del Mercado de Valores (CNMV), had issued a warning about Tresaderns. He also received some complaints from investors. These developments led to the Applicant taking the advice of Counsel and arranging a meeting with Mr Jeffrey Reade and a representative of the overseas companies which meeting was held at the offices of the Applicant on 24 March 2004. We now describe each of these developments in more detail.

May 2003 – the Authority's seminar

65. After approving the first two promotions, Mr Jones attended a one-day seminar on financial promotions given by the Authority on 8 May 2003. The seminar dealt with matters such as the regulatory objectives, the need for openness and transparency, the need to make the purpose of financial promotions clear and the need for balance in the documents. Reference was also made at the seminar to the paper entitled "The FSA's Approach to Financial Promotions" published by the Authority in 2002.

May 2003 - The Authority's press releases

66. On the day after the seminar, that is on 9 May 2003, Mr Jones read three press releases issued by the Authority. He had written to the Authority on 30 April 2003 referring to a press article published that day which implied that there was a list of unauthorized firms to be avoided and asking how he could access the list. On 9 May 2003 the Authority sent a copy of the list which appeared at the end of a press release dated 30 April 2003 and also informed Mr Jones how to access two previous press releases. Thus it was that on 9 May 2003 Mr Jones read the three press releases about "boiler rooms".

67. The first press release was dated 30 May 2000. It stated that the Authority had placed an alert on its consumer webpage following concern that unauthorized firms based overseas might be targeting United Kingdom investors using high pressure sales tactics to persuade them to buy shares which might not be suitable. The first communication from such firms could be by post and they might offer a free research report into a company in which an investor already held shares. The names of the investors would have been obtained from the share register. However, by asking for the research report investors also probably agreed to be contacted by the overseas firm. Then the investor would be "flooded with calls" offering a great deal on shares often in smaller companies which the investor might not have heard of. The firm's sales force would probably "sweeten, cajole, flatter, bully and sometimes threaten investors to take up the offer"; the sales force probably made a commission on every sale. The press release stated that the Authority could not tell readers what they should or should not do but suggested that they could check if the firm was authorized in the United Kingdom. However, the majority of firms operating from abroad were perfectly respectable. The Authority also advised investors to check the current price of the shares and to get evidence of what shares were sold to them.

68. The second press release was dated 24 May 2002. This was a warning from the Authority that investors should not deal with unauthorized overseas firms. Much of the content repeated that of the press release of 30 May 2000 but also stated that some investors experienced considerable delays in obtaining their share certificates. This press release also contained the names of eleven unauthorized overseas firms that might be targeting United Kingdom investors but added: "The FSA is not seeking to imply that any of these firms would necessarily deal with customers in the manner described above." The eleven named firms did not include any of the overseas companies for whom the Applicant acted.

69. The third press release was dated 30 April 2003 and published an updated list of unauthorized firms that were targeting United Kingdom investors; it stated that the number of such firms had nearly trebled in the previous year. Reference was made to the two previous releases which outlined the tactics commonly adopted by such firms but the third press release went on to add that the Authority was not seeking to imply that any of the firms would necessarily adopt such tactics. It was pointed out that investors dealing with such firms might be lucky and have no problems but if they did they would have no complaints or compensation scheme to turn to. Also a new development was that some of the shares sold by unauthorized firms were not listed on a recognized stock exchange. The list published with the third press release included the names of Condor and also the name of Walker Stone.

70. On 9 May 2003 Mr Jones sent an email to Condor referring to the press release of 30 April 2003. He also mentioned the seminar on 8 May and said that Condor would be pleased to hear that "we seem to be on the right lines". Much later, in October 2003, Mr Horsten of Condor told Mr Jones that it had suffered bad publicity from being included on the Authority's list of unauthorized overseas firms and that he and Mr Dimond had decided to operate instead through UMS which was then a newly formed Spanish company. The Applicant was asked to advise Condor about whether it could take proceedings for libel against the Authority but the advice was that, as the press releases did not state that every firm mentioned was unreliable, libel proceedings were unlikely to be successful.

71. For the sake of completeness we mention here that on 9 February 2004 the Authority published an updated list of unauthorized firms which then included Tresaderns and Benjamin Fisher. We also mention that, in responding to a complaint by an investor in 2006, the Authority stated that the rationale of the statement (that if investors put their money with unauthorized firms they would not get the benefit of United Kingdom compensation and complaint schemes) was to inform readers that the firms listed were outside the Authority's jurisdiction; the list did not state that consumers and firms were not allowed to deal with the overseas unregulated firms; on the contrary the list intended to warn consumers and firms that the overseas unregulated firms listed were outside the Authority's jurisdiction and any dealings that consumers might have with them would not be covered by UK compensation and complaint schemes.

July 2003 - The Authority visit the Applicant

72. In the Spring of 2003 the Authority initiated a research project into the approval by authorized firms of financial promotions for unauthorized persons, predominantly based overseas. Mr Clark was assigned to lead the project. The Authority was concerned because United Kingdom consumers dealing with such unauthorized persons did not have access to any compensation schemes. The project team identified 250 authorized firms (including the Applicant) who undertook the approval of financial promotions and each was sent a letter and a questionnaire. The Applicant replied to the letter and said that it had approved promotions for Condor and Tresaderns. From all the replies received, the project team identified ten firms to visit of which the Applicant was one.

73. The visit took place on 31 July 2003 when Mr Clark visited the Applicant with Ms Casey and a colleague. They met Mr Jones. The visit lasted one day. It was not a supervisory visit; the purpose was to obtain information. Quite a lot of time was spent looking at the work of the Entrepreneurs Club. At that time the Applicant had approved three promotions for the overseas companies, two for Condor and one for Tresaderns. The representatives of the Authority went through the systems and spoke to Mr Jones to find out how the Applicant dealt with the financial promotions. Mr Jones gained the impression that the Authority were not happy with the rules as they stood. The representatives of the Authority looked at the files but did not consider the content of the promotions. In his evidence Mr Clark said that he was looking for documents showing the due diligence done on the overseas companies. Mr Clark was surprised that no official translations had been made of the Spanish documents relating to Condor but did not ask that official translations be made. We accept the evidence of Mr Jones that the Authority appeared to accept the enquiries about the overseas companies that had been made and the way in which the financial promotions had been approved as no points were raised at the visit on these matters. Mr Jones was left with the understanding that the Applicant's systems, and the financial promotions that had been approved, were compliant with the rules.

74. During the visit reference was made to the list of unauthorized firms which had been published by the Authority on 30 April 2003. Mr Clark mentioned that Condor was on that list but Mr Jones pointed out that the list mentioned a number of unauthorized firms based overseas which were targeting United Kingdom customers but did not say which firms were to be avoided. In evidence before us Mr Clark agreed that

he did not say that the Applicant should not be doing business with any firm on the list but it was his view that the list amounted to a very strong warning.

75 On 4 September 2003 Mr Jones wrote to Mr Clark at the Authority and sent copies of the references the Applicant had obtained on Tresaderns. [It appears that the copy references for Tresaderns became mislaid but from the evidence of Mr Jones and Mr Clark we find that they were most probably sent with the letter. Copies of the originals were stored electronically by the Applicant but when printed were unreadable. For that reason copies of the references were not produced at the hearing.] Mr Jones' letter referred to a discussion at the visit on 31 July about the list of unauthorized firms to be avoided and stated that the list that Mr Jones had been sent was a complete list and did not differentiate between those who did and those who did not deal with investors in the United Kingdom in an honest and reliable way. The letter went on to say that Mr Jones had been asked by Condor to approve another promotion and asked Mr Clark to let him know as a matter of urgency if there were any grounds for not dealing with Condor or if the Authority was aware of it acting in an improper way; the letter also asked for the same information about the other firms for whom the Applicant acted or might act in the future.

76. Mr Clark replied on 17 September 2003. He gave no information about Condor or any other firm and said that it was "a commercial decision" for the Applicant, who should have mechanisms in place to ensure compliance with the rules and to ensure that the Applicant had assessed any risks to the statutory objectives. As a minimum the Authority would expect that full due diligence would be conducted into clients for whom the Applicant acted. The letter added that the position had not changed since the press release of 30 April 2003 but might change when Mr Clark had analysed his findings and made recommendations; however, the responsibility lay with the Applicant to ensure that it complied with both the letter and the spirit of the rules. In evidence before us Mr Clark agreed that there was nothing in his letter which was a criticism of the Applicant. He also added that it was his personal view that the Applicant should not have been dealing with any firm on the list but as a regulator he could not say that. He agreed that the press releases did not differentiate between overseas firms which acted honestly and those that did not, but he thought that it was necessary "to read between the lines".

77. We accept the evidence of Mr Jones that he read this letter as stating that a decision to continue to act for Condor was not a regulatory decision but a commercial decision. The Authority had seen the Applicant's files, had seen the way it operated, and had seen the systems it had and had not identified anything that the Applicant had done wrong.

2003 –2004 - Correspondence from the press

78. The correspondence from the press began on 2 June 2003 when a journalist wrote to the Applicant and said that a reader had contacted him about Tresaderns whose literature stated that its financial promotions were approved by the Applicant. The letter asked what enquiries the Applicant had made about Tresaderns to satisfy itself that investors would be dealt with honestly and fairly and the outcome of those enquiries. The letter added that Tresaderns appeared to be unknown to the CNMV and its corporate details in Spain described it as being in the credit reporting and debt collecting businesses, not stock broking.

79. Mr Jones replied on 1 July 2003 and confirmed that the Applicant acted for Tresaderns and had approved a financial promotion on its behalf. The Applicant believed that the promotion met the requirements of the Authority but asked the journalist to let the Applicant know if he had any information to suggest that Tresaderns did not deal with customers in an honest and reliable way as that would be relevant if the Applicant were asked to approve any further financial promotions.

80. Mr Jones and the journalist had a telephone conversation on 2 July 2003 and the journalist mentioned that Tresaderns were connected with the firm of Walker Stone who had been mentioned in the Authority's press release of 30 April 2003. The journalist also mentioned that Tresaderns was not registered with the Spanish authorities. On 6 July 2003 a press article appeared stating that Tresaderns had been incorporated in Spain in February 2003 as a credit checking firm and debt collection agency and that the chief executive of Tresaderns was the owner of Walker Stone who was on the Authority's public list. The article concluded that the law needed tightening.

81. There was then an interval until 27 October 2003 when the journalist wrote again to Mr Jones sending a copy of a letter from another reader about Tresaderns. Mr Jones took the matter up with Tresaderns who replied that Tresaderns was not described as a credit checking firm and debt collecting business in Spain; that the chief executive was a well-known lawyer in Spain who was on the board of several Spanish companies, and that Tresaderns could give no opinion on business conducted by Walker Stone.

82. On 12 November 2003 a colleague sent Mr Jones a copy of a letter from Walker Stone to its clients saying that it was ceasing its activities in the United Kingdom. Mr Jones was told that one of the brokers at Walker Stone had moved to Benjamin Fisher. On 18 November 2003 the journalist wrote again to Mr Jones and sent him a copy of a complaint about Walker Stone which linked that firm to Tresaderns. Mr Jones was also told that the Spanish regulator, the CNMV, had issued a warning about Condor. Mr Jones became concerned about these matters and took them up with Mr Manning by memorandum dated 19 November 2003. This, together with the other developments, led to the Applicant arranging a meeting to be attended by Mr Reade and representatives of the overseas companies and which was ultimately held in March 2004.

83. A further press article about Tresaderns appeared on 21 December 2003 and the Applicant was mentioned by name. Another press article appeared on 17 January 2004 stating that Tresaderns had been the subject of a notice by the Spanish regulator and mentioning the Applicant by name. The article reported the Applicant as stating that the regulatory warnings had rung alarm bells and that the partners were to meet to discuss matters. Further articles appeared in on 20 January 2004, 21 February 2004 and 29 February 2004.

December 2003 – the warning of the Spanish regulator

84. On 16 December 2003 CNMV published a statement warning the public about Tresaderns and stating that it was not authorized to provide investment services under Spanish law and that four persons, including Daniel Tresadern, were business –related to Tresaderns. Mr Jones asked Tresaderns about the statement and Tresaderns replied that they were not in breach of Spanish regulations as they only sold shares to investors in the United Kingdom. Mr Jones was of the view that Tresaderns was complying with

the Authority's rules in the United Kingdom because the financial promotions were approved by the Applicant and, because of the operation of the escrow account, Tresaderns was acting honestly and reliably as regards United Kingdom investors. However, Mr Jones regarded this as another matter to be discussed at the proposed meeting with Mr Reade.

April 2003 –2004 The complaints from investors

85. Between April 2003 and June 2004 the Applicant received a number of complaints from investors about the overseas companies. None of the complaints concerned the content of the documents approved by the Applicant or the operation of the escrow account. The complaints were sent after the investors had received from the Applicant the details of the operation of the escrow account. In the following summary Co means overseas company; Condor is referred to as C; Tresaderns as T; and Benjamin Fisher as BF. NK means not known.

No.	*Date*	*Co*	*Comment*
1.	04.03	C	Investor had paid 14 cents for shares issued at one cent.
2.	06.03	T	Investor did not want to buy shares and T kept telephoning him.
3.	06.03	T	Investor could ill afford to buy and did not want high-risk shares
4.	06.03	T	Investor had made it clear he did not wish to buy shares.
5.	07.03	T	The price of shares had plummeted and investor wanted to cancel
6.	07.03	T	Investor had decided not to buy and "did not wish to be hounded"
7.	07.03	T	Investor unhappy about pressure and wanted to cancel
8.	08.03	T	Investor had not been told about restrictions on sale of shares
9.	08.03	T	Investor wished to cancel as company was "in severe trouble".
10.	12.03	T	Investor wished to cancel – he had been "bombarded".
11.	01 04	T	Investor did not want to proceed – T was like a "boiler room".
12.	02.04	T	Investor said she had been harassed– her husband had had a stroke
13.	02.04	T	Investor complained of "undue pressure".
14.	02.04	NK	Investor wanted her cheques put on hold .
15.	03.04	C	Investor had not received share certificates after nine months
16.	03.04	BF	Investor had "persistent telephone calls" and did not want to buy
17.	03.04	T	Investor had an abusive call when he decided not to buy
18.	04.04	T	Investor had an abusive call after he pulled out of a deal
19.	04.04	T	Investor did not get the shares he asked for and did not want to switch
20.	04.04	T	Investor wanted 6,000 shares but later told he had to take 10,000
21.	05.04	T	Investor wanted shares in another company and no restrictions
22.	05.04	T	Investor wanted money back - shares "extremely dubious".
23.	06.04	T	Investor told he would lose his money if he did not switch

86. The investors were not, of course, clients of the Applicant. The Applicant had a procedure for dealing with complaints from its clients but initially there was no established procedure for dealing with these complaints. For that reason the complaints were initially seen by different people in the Applicant. Later, a system for dealing with the complaints was established.

87. The Applicant took up each complaint with the overseas company concerned. If a complaint was about sales tactics the Applicant was told that the salesman would be disciplined. Where an investor wanted to cancel a deal it was cancelled. Where an investor wanted his money returned, and it was still in the escrow account, it was returned. For example, on 30 June 2003 Mr Jones wrote to Tresaderns about the

complaints and mentioned that the Applicant had to verify that Tresaderns would deal with private customers in the United Kingdom in an honest and reliable way. Investors had been told on the telephone that some shares carried no risk or that a large profit would be made but that conflicted with the documents sent to investors by the Applicant. Some investors complained of repeated calls when they were not interested in investing. Mr Jones asked Tresaderns to investigate these matters. Tresaderns wrote to the investors with an apology and also sent Mr Jones a copy of their compliance menu which was a code of conduct for dealing with complaints.

2004 - The meetings between the Applicant and Mr Reade

88. As mentioned above, on 19 November 2003 Mr Jones wrote a memorandum to Mr Manning about the correspondence from the press. In December the Applicant took the advice of Counsel (which we did not see). We accept the evidence of Mr Jones that the Applicant wished to be fair to its clients (the overseas companies) and give them a chance to improve their procedures so that they could show that they were operating honestly and reliably. Accordingly, Mr Manning arranged a meeting with representatives of A Street Capital and the overseas companies to review matters. Because of the prior commitments of those invited to the meeting it did not take place until 24 March 2004. Shortly before the meeting, the staff of the Applicant sent a memorandum to Mr Manning and Mr Jones saying that Tresaderns were harassing the staff and that Mr May was treating people in an unacceptable way.

89. A comprehensive agenda for the meeting on 24 March 2004 was prepared by Mr Jones and the main items for discussion were: firm approval; financial promotions; escrow accounts; and costs. Mr Jones had also prepared a draft code of conduct for the sale of OTC Bulletin Board shares by telephone. This dealt with very many matters of which a few were: that an overseas company would only recommend shares in companies it had investigated; would treat all investors with respect, courtesy and in good faith, would act in a professional manner and not bully investors; would make the restrictions on sale clear, and would operate a complaints procedure.

90. The meeting on 24 March 2004 was attended by Mr Manning and Mr Jones for the Applicant with Mr Reade of A Street Capital, Mr May of Zetland and Mr Ian Hughes who represented both Tresaderns and Benjamin Fisher. (Mr Hughes arrived late). It was agreed that the code of conduct drafted by Mr Jones should be used subject to any detailed comments to be made by Tresaderns. (In fact the code did not come into effect before the Applicant ceased to act for the overseas companies). Mr Manning and Mr Reade left the meeting early.

91. A further meeting was held on 11 May 2004 attended by Mr Manning, Mr Jones and Mr Reade. The meeting discussed the remuneration received by the Applicant for the work done for the overseas companies. In addition to the remuneration based on the time spent in approving the financial promotions, the Applicant had been receiving $60 for each transaction which went through the escrow account. It was then agreed that after 1 April 2004 the Applicant would also receive 1% for each transaction. Mr Reade was happy with the proposed compliance programme and suggested that advice be taken from a firm of consultants. Mr Manning suggested that the salesmen's telephone calls should be monitored or tape recorded with an opportunity for the Applicant to make spot checks and the possibility of compliance visits by the Applicant to the overseas companies was also discussed.

June 2004 - The Applicant ceases to act for the overseas companies

92. However, before these matters could be implemented the Applicant decided, in June 2004, to cease to act for the overseas companies. The decision was made because the Authority had begun an investigation into the Applicant. No further financial promotions were approved after June 2004 but the escrow account continued to be operated until all the investors had received their share certificates.

2003 – 2004 - The developments within the Authority

94. Before describing the investigation into the Applicant which was conducted by the Authority we first summarize the developments which took place within the Authority (unknown to the Applicant) about the Authority's approach to unauthorized overseas firms.

95. It will be recalled that Mr Clark of the Authority had visited the Applicant on 31 July 2003 as part of a research project into financial promotions. On 2 October 2003 an internal file note of the visit was made and listed some "issues to note". These included: the fact that the Applicant did not know the introducer of the companies; the blacklist; the fact that the references for Condor had been in Spanish; and the fact that the complaints files had not been examined. We accept the evidence of Mr Jones that these matters were not mentioned to him at the visit on 31 July 2003. (Neither were these matters mentioned to the Applicant in the letter written by the Authority on 17 September 2003 nor indeed does it appear that they were they mentioned to the Applicant at any time before the commencement of the investigation in April 2004.) There was no mention in the internal note that the promotions had not been clear, fair and not misleading.

96. On 22 October 2003 an interim report was prepared within the Authority about the risk to consumers of authorized firms approving financial promotions for unauthorized persons. The report identified the intended outcomes of the project one of which was identifying best practice for the checks which an authorized firm should carry out and another was proposed rule changes if appropriate. The report mentioned that authorized firms approving financial promotions on behalf of unauthorized persons must "have no reason to doubt that the overseas person will deal with private customers in the United Kingdom in an honest and reliable way". It went on to note that there was no amplifying guidance (a weakness which was acknowledged by staff in the Conduct of Business Division), and that this put a highly subjective burden of due diligence on the authorized firm with regard to the products and services of the unauthorized firm.

97. On 9 December Mr Clark wrote to the chief executive of the Authority in response to issues raised by a press article and mentioned the project about financial promotions. Mr Clark stated that eleven firms had been visited, the last in November 2003. The firms approving financial promotions for overseas firms had given a number of issues for concern relating to matters mentioned in the press releases. Systems and controls for approval were poor, due diligence on the unauthorized firms was weak or not undertaken, and record keeping was not sufficiently robust. The Applicant was referred to by name with the comment "Poor systems and controls; they ignored FSA guidance issued in press releases. They continued to approve unauthorized firms' promotions despite oral warnings from FSA Project Team. Although potentially not in breach of FSA rules we consider this a breach of principles." In evidence before us Mr

Clark accepted that the "oral warnings" referred to were not formal warnings but referred to the discussion at the visit in July 2003 about dealing with unauthorized firms.

98. The note of 9 December 2003 continued with a list of matters for further action. This included further guidance or a change in the rules so that unauthorized firms would be required to be authorized and comply with all the Conduct of Business rules and customers would be protected under the Financial Ombudsman Scheme and the Financial Services Compensation Scheme. Another matter for further action was "possible action against firms for breach of Principles, given the unsatisfactory nature of the rules and use of leverage to promote message". This meant that if action were taken against a firm it could be used to publicize the action taken by the Authority. The note concluded that Enforcement had agreed to take the case of the Applicant "in order to establish a line in the sand. They have said that given the weakness in the rule it will be a difficult case to take forward and may not succeed. However, it is important to demonstrate that the FSA is prepared to take action in this area."

99. On 5 February 2004 Mr Clark sent a formal proposal about the Applicant to Enforcement but indicated that action was not urgent. Urgent was defined as "information indicating significant loss, risk of loss or other adverse effects for consumers or potential consumers, where action is necessary to protect their interests".

April 2004 – The Authority's investigation into the Applicant

100. After the correspondence in September 2003 the Applicant did not hear from the Authority until 28 April 2004 when the Authority notified the Applicant that it had appointed persons to carry out an investigation into the approval of financial promotions for unauthorized overseas persons and the adequacy of systems and controls for such approvals. Mr Jones replied to say that it would be helpful if the Authority would indicate which of the rules or principles for businesses the Authority considered might have been broken as the Applicant was still dealing with such matters and would not wish to continue to do so if there was a breach of which it was not aware and which could not be remedied. No reply was received to this letter.

101. The Authority's research project was completed in July 2004. The final report mentioned a number of recommendations for further work. It stated that a number of issues relating to the communication and determination of final outcomes were dependent on the Applicant's case which might set a precedent to be used as a basis for guidance on best practice and "leverage of messages" to the industry. Other recommendations included rule changes although it was noted that this had difficulties as a result of European directives and competition rules.

The Decision Notice

102. The Decision Notice was issued on 29 September 2006. One of the factors taken into account by the Authority in fixing the level of the penalty was that the Applicant had not profited to any great extent from the business. The Authority was told that gross fees of £178,424 had been paid to the Applicant for the work done for the overseas companies. As the ratio of profit to gross fees over the same period was 16.8% the Applicant calculated that £29,975 was the profit made. At the hearing we asked to be supplied with a note of the amount received by the Applicant as interest on its client

account with respect to the escrow account and the parties informed us on 9 July 2007 that the agreed amount was £15,073.22.

The events shortly before the hearing

103. The Applicant's skeleton argument put in prior to the hearing contained a footnote that Mr Manning had received a commission in respect of the business done by the Applicant for the overseas companies. The Authority asked for more information and the following facts emerged during the hearing.

104. In or about January 2006 a query arose about whether all the remuneration due to the Applicant from the overseas companies had been paid. Mr May of Zetland sent Mr Manning an email with a spread sheet attachment showing the position as he understood it. Mr Manning asked an assistant in the Applicant's accounts department to check the spread sheet from which it emerged that between 21 May 2004 and 13 December 2004 Mr Manning had been paid six amounts of commission equal in total to 4% of the monies that passed through the escrow account. The total amount of commission paid to Mr Manning during that period was $518,149. The assistant had not known about the commission and asked Mr Jones who had not known about it either. Mr Jones consulted the managing partner who also had not known about it.

105. A meeting of the four-partner Executive Committee of the Applicant (attended by Mr Jones) was held on 30 January 2006 when Mr Manning explained that the payments made to him were in respect of losses suffered on personal investments and were not income of the Applicant. He told the meeting that he had put his own money into some companies which had floated on the OTC Bulletin Board and it was the shares of those companies that were later sold through the overseas companies to investors. He had put between $400,000 and $500,000 into each company. When the shares were sold by the overseas companies the proceeds of sale were split as to 60% going to the OTC Bulletin Board companies and 40% going to Mr Manning and other persons. For this Mr Manning had received commission at the rate of 4% on the amount going through the escrow account since January 2003. The Executive Committee was of the view that the Applicant should have been told about the payments but accepted Mr Manning's statement that they were not partnership income. Because at that time the Authority's investigation into the Applicant was continuing (the Decision notice was not issued until September 2006), the Applicant took the advice of Counsel as to what should be disclosed to the Authority.

106. Counsel's advice was given on the basis that Mr Manning was personally interested in certain of the companies whose shares were sold by the overseas companies. Counsel advised that the connection between that personal interest and the approval of the promotions was remote and, as the Applicant had been unaware of the interest at the time the financial promotions were approved, it could not have affected the behaviour of the Applicant. For that reason the receipt by Mr Manning of the 4% commission was not mentioned to the Authority in 2006.

Mr Manning's evidence to the Tribunal

107. On 19 March 2007 Mr Manning signed a witness statement containing evidence to the Tribunal. On 11 June 2007 (which was during the course of the hearing before us) Mr Manning signed a second witness statement and this paragraph of our Decision summarizes the contents of the second witness statement. The statement recorded that,

in the transactions with which Mr Manning had been involved in 1999, money was raised from smaller investment banks in the United States who typically paid $1.5M at the outset in exchange for 35% of the shares in the company to be floated and also paid the professional costs of the flotation. The investment banks were looking for companies worth about $10M which would give them a profit if all the shares were placed; however in about 2000 it became difficult to find investment banks and so Mr Manning decided to provide finance personally. At this stage Mr Pollock introduced Mr Manning to Mr Reade. When Mr Manning met Mr Reade in New York in 2002 he had been introduced to one of Mr Reade's colleagues who had since died. The colleague had said he would invest in three companies that Mr Manning wanted to float on the OTC Bulletin Board, subject to due diligence. The colleague did invest in one of the companies. In reliance on the colleague's promise to invest in the other two Mr Manning invested in all three companies and gave bank guarantees worth in total more than £1M. On 11 September 2001 the offices used by the colleague were seriously damaged and as a result one of the two companies did not float and the float of the other was delayed and did not raise the amount expected. Because the investment promised by the colleague did not take place both companies failed, one in 2003 and one in 2004. Mr Manning lost significant sums. After the meeting in March 2004 Mr Manning and Mr Reade had had a subsequent meeting when Mr Reade had agreed that the Applicant should receive a commission of 1% and that Mr Manning should be paid a sum equal to 4% of the sums realized from the financial promotions as compensation for the losses sustained by Mr Manning. and to pay Mr Manning for assisting Mr Reade to acquire financial services companies in the United Kingdom and to find other companies that Mr Reade could float on NASDAQ.

108. In oral evidence before us on 13 June 2007 Mr Manning accepted that he had not been candid with his partners at the meeting in January 2006 and that he had misled them. He also stated that the agreement for the payment of the 4% commission was made with Mr Reade in Spain in 2002 and not, as mentioned in his second witness statement, in 2004 although he added that the commission had been confirmed after the meeting in March 2004. The commission was not paid, as he had said in January 2006, because he had personally invested in the companies whose shares were sold by the overseas companies but because he had lost money as a result of the actions of the colleague of Mr Reade. Although he accepted that the commissions had commenced in January 2003 Mr Manning was unable to provide any documents to show the total amount of commissions received, other than those received between May and December 2004. He said he had a number of bank accounts and did not remember how he received the money before May 2004. When it was put to him that if the total payments into the escrow account amounted to $21M then, at the rate of 4%, he would have received between $800,000 and $900,000 Mr Manning said that he could not recollect how much he had received before May 2004. He had not declared the commission on his income tax return because he had treated it as a capital and netted it off against his capital losses which were thus reduced. These are large sums and Mr Manning is a solicitor. We do not find it credible that he had no means of finding out how much he actually received as commission.

Our findings about the commissions

109. In reaching our findings about the commissions we bear in mind that these commissions were not disclosed to the Applicant until 2006. We also bear in mind that Mr Manning accepted that he had not been candid with his partners and had misled

them and he also gave inconsistent statements to the Tribunal about the date upon which, and the reasons why, he had received commissions related to the amounts which went through the escrow account We formed the view that it would be unsafe to rely upon the evidence of Mr Manning unless it was corroborated by other reliable oral or contemporaneous documentary evidence or was otherwise inherently probable.

110. As far as the date of the commencement of the payments, and the amount paid, are concerned, the only documentary evidence was the spread sheet showing the amounts paid between May and December 2004. Although payments may have been made after January 2003 and before May 2004 there is insufficient evidence for us to reach any view about the date when the payments commenced or the total amount.

111. Turning to the reason for the payments, we do not accept either of Mr Manning's explanations. There was no documentary evidence to support his statement made in January 2006 that the payments were made because he had invested in the companies whose shares were sold by the overseas companies and, in any event, he admitted before us that that statement was not true. And there was no documentary evidence to support his statement that Mr Reade had agreed voluntarily in 2002 to compensate Mr Manning for losses he had suffered with his personal investments because of the lack of financial support from Mr Reade's colleague. We find that statement to be intrinsically improbable. On the evidence before us we find that the payments were made to Mr Manning because he arranged for the Applicant to undertake the work done in connection with the financial promotions. We also find that, other than the matters that were discussed in January 2006, these facts were unknown to the Applicant until the penultimate date of the hearing before us when Mr Manning gave oral evidence.

112. On the last day of the hearing we were informed that Mr Manning had resigned from the Applicant that morning with immediate effect.

The oral evidence of the investors

113. Before concluding our findings of fact we here summarise the oral evidence given by the seven investors at the hearing. This evidence was also contained in written statements made in February and March 2007. We accept the evidence of Mr Jones that, although he was aware of all the complaints made by investors to the Applicant, he was not aware of this further evidence before the dates of these statements.

114. Of the seven investors who gave oral evidence five were retired. Three had sent a complaint to the Applicant and they were investors No. 9, 17 and 19 in the list of complaints above. Each owned some shares before being telephoned by Tresaderns. Most agreed on the telephone to buy shares for about £2,500. One investor did not buy any shares and five later made other purchases, spending about $250,000 in one case and $100,000 in another. Most expressed the view that Tresaderns had been "very enthusiastic" about the shares, some stated that they had been put under pressure to buy and one said that he had been bullied and telephoned three or four times a day. The investor who did not buy shares stated that he had been insulted. The investors who did decide to buy said that they had been reassured by the involvement of the Applicant. Two later had doubts about their investment and asked for their money back; the Applicant returned the money without argument. The investor who said he had been insulted complained to the Applicant who took the matter up with Tresaderns who sent

an apology to the investor. At least one of the investors knew that the offer of a free research report was made in order to get information from him. Some stated that Tresaderns had not told them that there were any restrictions on the sale of the shares. Most of the investors who purchased shares saw their value drop over time.

115. In the long term almost all of the shares sold by the overseas companies lost most of their value. We saw a table of shares in twenty OTC Bulletin Board companies with their price at the date of the first deal and the price as at January 2005. Two prices had remained the same, one price had increased, and the prices of three were not given. The other prices had dropped. At the hearing we were told that the shares of one of the companies had done well.

Reasons for decision

116. The Authority's rules with which we are concerned are only expressed to apply to non-real time financial promotions. The Authority accepts that the rules do not apply to real-time financial promotions, that is promotions made over the telephone. The oral evidence we received from the investors, and the written complaints made to the Applicant, all concerned the real-time financial promotions made by the overseas companies over the telephone direct to the investors and the sale of the OTC Bulletin Board shares.

117. The Applicant was not involved in the sale of the OTC Bulletin Board shares. It approved the initial letters and the research reports into the United Kingdom companies and it operated the escrow accounts. There were no complaints about any of these matters. All the complaints arose either from what were said to be the high pressure sales tactics employed by the overseas companies or, much later, from the fact that the OTC Bulletin Board shares fell in price. In particular, the documents prepared by the Applicant made it clear that it had no involvement in advising on the suitability or value of the investments. Indeed, the operation of the escrow account, and the documents sent by the Applicant to the investors, meant that if any investor had been subject to pressure to buy he was given a "cooling-off" period before paying for his shares and was also warned before payment that the shares were high risk and subject to restrictions.

118. With that in mind we now turn to consider each of the issues for determination in the reference.

Issue (1) –Clear, fair and not misleading

119. The first issue is whether the Applicant took reasonable steps to ensure that the promotions were clear, fair and not misleading within the meaning of COB rule 3.8.4R1 which provides:

> **"3.8.4R.1 A firm must be able to show that it has taken reasonable steps to ensure that a non real-time financial promotion is clear, fair and not misleading."**

120. Rule 3.8.5E is an evidential provision and the relevant part provides:

> **"3.8.5E**
> **(1). A firm should take reasonable steps to ensure that, for any non-real time financial promotion:**
> **a its promotional purpose is not in any way disguised or misrepresented;**

(b) any statement of fact, promise or prediction is clear, fair and not misleading and discloses any relevant assumptions; …

(e) it does not contain any false indications , in particular as to:
(i) the firm's independence;
(ii) the firm's resources and scale of activities; or
(iii) the scarcity of any investment or service.

(h) it does not omit any matters the omission of which causes the financial promotion not to be clear, fair and not misleading.

(i) the accuracy of all material statements of fact can be substantiated.

(2)
(a) Compliance with COB 3.8.5E(1) may be relied on as tending to show compliance with COB 3.8.4R(1).
(b) Contravention of COB 3.8.5E(1) may be relied on as tending to show contravention of COB 3.8.4R(1).

121. Rule 3.8.7G gives guidance about non-real time financial promotions and the meaning of clear, fair and not misleading. Rule 3.8.7.G(1) provides:

"3.8.7G(1) It cannot be assumed that recipients necessarily have an understanding of the investment or service being promoted."

122. In considering this issue we first identify the non-real time financial promotions approved by the Applicant. They were the initial letters (with the response form and the terms and conditions) and the research reports. These were financial promotions because the research report might lead an investor to sell the shares he already held in the United Kingdom company or to buy some more of the same shares. An investor to whom the initial letter was sent did not have to ask for a research report. If he did ask, the response form contained a statement (which could be deleted) that the investor consented to further communications from the overseas company about the services they offered. It was also made clear that the investor was under no obligation to transact any business with the overseas company. The terms and conditions sent with the initial letter emphasized the need to seek independent advice and also mentioned investment in companies not quoted in the United Kingdom. The research reports were all checked by the Applicant for accuracy and there were no complaints from investors about their content. Although the Authority did not necessarily accept that the reports were good reports they did not argue that they were deficient in any particular way.

123. Although the operation of the escrow account was not a financial promotion, it contained additional safeguards for investors who had agreed on the telephone to buy OTC Bulletin Board shares. The documents sent with the letter from the Applicant about the escrow account mentioned the restrictions on the sale of the shares (although perhaps they should also have mentioned that restrictions also applied in the second twelve months after purchase). The documents sent from the Applicant about the escrow account also stated that the purchase of shares in smaller quoted companies was a speculative investment carrying a high degree of risk with no assurance of any return and mentioned the need for independent advice. The way in which the escrow account worked also meant that an investor who had second thoughts about his purchase could decide not to proceed. The Authority argued that, as a matter of law, the sale of the shares had taken place over the telephone and the investor was then bound to proceed. We need to reach no conclusion about the legal position because in practice the

operation of the escrow account did constitute a cooling-off period and we heard of no case where an investor was not allowed to cancel an agreement reached on the telephone so long as he had not paid any money or his money was still in the escrow account.

124. The Authority referred to section 21 of the 2000 Act and argued that the initial letters approved by the Applicant were not only invitations to send for a research report (which itself contained investment advice) but were also inducements to engage in the purchase of the OTC Bulletin Board shares and so were promoting both the research reports and the sale of the OTC Bulletin Board shares. It was their view that the initial letters should have disclosed that the purpose of the research reports was to enable the overseas companies to telephone the investors in order to sell a very limited selection of high-risk, illiquid shares in companies quoted on the OTC Bulletin Board in the United States. The Authority thought that any recipient of the letter would have assumed that a wider range of shares was on offer. The Authority also argued that the research reports were financial promotions because they were inducements to purchase the OTC Bulletin Board shares.

125. In our view the initial letters were not inducements to engage in the purchase of the OTC Bulletin Board shares. They were an invitation to send for a research report into a United Kingdom company in which an investor already held shares and to be contacted about other services. Similarly the research reports themselves were not inducements to purchase OTC Bulletin Board shares but could have been inducements to sell, or buy more of, the United Kingdom company shares. An investor who asked for a research report had separately to consent to being contacted about the purchase of other shares including the OTC Bulletin Board shares. At least one of the investor witnesses we heard accepted that they knew that if they asked for a research report they would also hear about other services. Also, the terms and conditions sent with the initial letter mentioned that the overseas companies provided opportunities for clients to invest in companies which were not quoted in the United Kingdom.

126. We accept that the Applicant knew that the whole purpose of the offer of free research reports was to obtain the consent of investors to be contacted by the overseas companies who would then try to sell the OTC Bulletin Board shares to the investors. However, there was nothing in the Conduct of Business Rules which would prevent this and there was nothing in the Rules to prevent the overseas companies from gaining access to the United Kingdom investors in this way.

127. In our view the Applicant did take reasonable steps to ensure that the financial promotions it approved were clear, fair and not misleading.

Issue (2) –Honest and reliable

128. The second issue is whether the Applicant had reason to doubt that the overseas persons would deal with customers in the United Kingdom in an honest and reliable way within the meaning of COB rule 3.12.6R(2); The full text of rule 3.12.6R is:

> **"3.12.6R A firm must not communicate or approve a specific non-real time financial promotion which relates to an investment or service of an overseas person, unless**
>
> **(1) the financial promotion makes clear which firm has approved or communicated it and, where relevant, explains:**

(a) that the rules made under the Act for the protection of private customers do not apply;

(b) the extent and level to which the compensation scheme will be available, or if the scheme will not be available, a statement to that effect; and …

(2) the firm has no reason to doubt that the overseas person will deal with customers in the United Kingdom in an honest and reliable way."

129. The Authority accepted that the financial promotions approved by the Applicant complied with rule 3.12.6R(1)

130. There was some argument by the parties as to whether the test in rule 3.12.6R(2) was subjective or objective. In our view we should first decide as a matter of fact what information was in the possession of the Applicant and then decide if the possession of that information should have led the Applicant to doubt that the overseas companies would deal with customers in the United Kingdom in an honest and reliable way. We have formulated our findings of fact so as to describe the facts in the possession of the Applicant at the relevant time. We now consider whether, and, if so, when the possession of that information should have caused doubt in the mind of the Applicant.

131. We begin our consideration of this issue by referring to an argument for the Authority that the whole point of the rule is to protect investors at the point of contact with the overseas companies who were selling shares, that is at the point of sale. But the difficulty with the rules we are considering is that that is what they do not do. The rules regulate financial promotions approved by authorized persons but they do not regulate the telephone calls made by the overseas unauthorized person. The Applicant was not involved with those telephone calls and had no responsibility for them. The calls are, however, relevant because they gave rise to complaints which happened to be sent to the Applicant because it operated the escrow account.

The enquiries about the overseas companies

132. We next consider a suggestion made by the Authority that the Applicant should have made more enquiries about the overseas companies than it did. The Authority argued that the Applicant had an obligation to take up references from the overseas companies and to obtain evidence from them that they had the ability competently and responsibly to produce the research reports and also to advise on and sell the OTC Bulletin Board shares.

133. As far as the references were concerned, the Applicant did make enquiries. We accept that some of the references for Condor were in Spanish but these were translated in the office of the Applicant. The constitutional documents for Tresaderns were in Spanish but Mr Jones' colleague told him what they said. We did not see the personal references for Tresaderns but have accepted the evidence of Mr Jones that copies were sent to the Authority (and later mislaid) and that the copies of the originals which were stored in the computer had become unreadable. We express our views about the adequacy of the references when considering issue (4) below.

134. However, within the context of the "no reason to doubt" rule we are of the view that there was no obligation to make enquiries. The rule does not say "must ensure". Furthermore, the Authority had not issued any guidance to assist authorized persons on what enquiries or "due diligence" it expected them to make and we accept Mr Jones'

evidence that the seminar did not cover this. For this reason we are also of the view that the adequacy or otherwise of the references is not relevant in this context (although it could be relevant in the context of the Principles (see issue (4)). Also, we do not agree that the Applicant had an obligation to obtain evidence from the overseas companies that they had the ability to produce the research reports and to advise on and sell the OTC Bulletin Board shares. It would have been possible for an overseas company to out-source the preparation of a research report and there was some evidence that this was done by at least one overseas company. The Applicant was obliged to ensure that the research reports were clear, fair and not misleading but was not obliged to ensure that they were of high quality. Also, it was the regulatory function of the Applicant under the rules to approve written financial promotions not to supervise the sale on the telephone of the OTC Bulletin Board shares.

What the Applicant knew at the outset

135. However, we are also of the view that the "no reason to doubt" rule does mean that the firm must consider all the information in its possession when deciding whether the overseas person will deal with customers in an honest and reliable way. We regard it as relevant that the Applicant knew from the outset that it was instructed to approve the financial promotions and that it was instructed to operate the escrow account so as to ensure that an investor's money was not parted with until the investor received a share certificate. In our view it was reasonable for the Applicant to take these factors as being indicators at the outset that the overseas companies intended to deal with customers in the United Kingdom in an honest and reliable way.

136. As the work for the overseas companies progressed the information in the Applicant's possession came to include the Authority's press releases, the statements made by the Authority at the visit on 31 July 2003, the correspondence from the press, the warning of the Spanish regulator, and the complaints from investors. We therefore consider each of these factors in turn.

The press releases

137. Beginning with the Authority's press releases we regard it as relevant that at no time did the Authority allege that the shares sold by the overseas companies were "scam" shares nor did the Authority tell us that it had received a significant number of complaints about the shares sold by the overseas companies. We also regard it as relevant that all the press releases stated that not all overseas unauthorized firms were unreliable. It is also relevant that Mr Jones asked the Authority which of the firms were unreliable but was not told. The Authority may have had good reason for not publishing a direct statement that all the firms on its list were unreliable. However, in the absence of such a direct statement, it is difficult to criticize readers of the statement for failing to appreciate that that was what the Authority meant. As Mr Hollander put it, the Authority cannot have it both ways. Either warnings should be given in clear and fair language but, if that cannot be done, then it has to be accepted that the statements cannot fairly be treated as warnings.

138. We accept that there were some similarities between the method of operation of the unauthorized firms mentioned in the press releases and those of the unauthorized firms who were the Applicant's clients. Both offered a free research report about shares already held by an investor and in both the details of investors were obtained from the share register.

139. However, the method of operation of the overseas companies who were the clients of the Applicant had many differences from the method disapproved in the Authority's press releases. We had no evidence that the clients of the Applicant made any unsolicited calls and the evidence was that every investor they called had agreed in writing to the contact. The investors who purchased shares from the clients of the Applicant always got the shares they agreed to buy and, if they did not, they had their money returned. The shares sold by the clients of the Applicant were genuine shares in genuine companies listed on the OTC Bulletin Board about which information and prices were available on the internet. Before an investor parted with his money he signed a declaration that he knew that he was buying high risk shares and that he should take independent advice unless he was an experienced investor. It was always open to an investor to decide not to proceed after receiving the letter and other documents from the Applicant about the escrow account. The escrow account ensured that the overseas companies always supplied share certificates or the investor got his money back.

140. We therefore conclude that the press releases by themselves did not give the Applicant reason to doubt that the overseas companies who were their clients would treat customers in the United Kingdom in an honest and reliable way.

The Authority's seminar and visit

141. Turning to the Authority's seminar on 8 May 2003, the visit on 31 July 2003, and the subsequent correspondence between Mr Jones and the Authority, it is relevant that at no time was Mr Jones told that he should cease doing business with any firm on the Authority's list of unauthorized firms. Also at no time during or after the visit was Mr Jones advised by the Authority to change the way in which he worked for the overseas companies. In his letter of 4 September 2003 Mr Jones specifically asked the Authority whether there were any grounds as to why he should not act for Condor or for any of the other firms for whom the Applicant acted. In our view the Authority's letter of 17 September 2003, stating that that was a commercial decision for the Applicant, did nothing to assist. If the concerns of the Authority had been expressed at the visit in July 2003, when all the then current files were available for inspection, or in the September letter, it is very possible that the Applicant might not have approved the remaining promotions. But the fact was that no concerns were expressed before April 2004. In our view nothing which occurred at the seminar, or at the visit, or was mentioned afterwards in correspondence, gave the Applicant reason to doubt that the overseas companies for whom it acted would be honest and reliable.

The complaints from investors, the press and the Spanish regulator

142. As far as the complaints from investors are concerned, we accept that the Applicant took up all the complaints it received with the overseas companies and believed that they were dealt with appropriately and promptly. The number of complaints (23) was small compared with the number of deals (1,920) and the number of investors who had purchased shares from the overseas companies (670). Also, although we were able to consider all twenty-three complaints one after another, we appreciate that the Applicant only saw them one at a time over a period of fourteen months. As far as the matters referred to in the press were concerned we accept that these were anecdotal only. As far as the Spanish regulator was concerned we accept that the Applicant took instructions from Tresaderns who said that they were not acting in

breach of Spanish law and, that as Tresaderns only sold shares to United Kingdom customers, it did not need to be regulated in Spain.

143 Nevertheless, in our view the cumulative weight of the correspondence with the press, the notice from the Spanish regulator, and the complaints from investors, all pointed in the same direction and should have given the Applicant some cause for doubt about whether Tresaderns and the other overseas companies would treat United Kingdom investors in an honest and reliable way. In our view an investor is not treated in a reliable way if he is subjected to undue pressure, or if he is not told about the restrictions on the sale of shares, or if he is sold shares in a company which is known to be in difficulty. We appreciate that the operation of the escrow account in fact gave investors a "cooling-off" period and that the document sent to investors with the details of the escrow account warned them that there were restrictions on the sale of the shares and that the shares were high-risk. We also appreciate that the evidence given at the hearing by the investor-witnesses of their losses was not known to the Applicant at the relevant time. Nevertheless, within the context of this issue we have to consider the way in which the overseas companies dealt with customers in the United Kingdom not the way in which the Applicant dealt with the documentation and the escrow account. We have no criticisms of the latter but we do have reservations about the former.

The time of the reason to doubt

144. The question then arises as to when the reason to doubt should have arisen. As Mr Jones said in evidence: "At the beginning there was no reason to think that these things [the complaints] were anything untoward. Towards the end I was beginning to have some doubts".

145. We are of the view that by mid-November 2003 the Applicant did have reason to doubt that the overseas companies would treat customers in an honest and reliable way. The correspondence from the press was increasing and the Applicant had received a number of complaints. We know that Mr Jones was concerned on 19 November 2003 because he sent a memorandum of his concerns to Mr Manning on that date. The Applicant could have ceased to act at that stage pending the meeting with Mr Reade which was arranged later. .

146. It was suggested by the Authority at the hearing that the fact that Mr Reade was prepared to pay secret commissions to Mr Manning cast some doubt about the suitability of Mr Reade to introduce business to the Applicant. Mr Hollander accepted that if Mr Manning personally had some knowledge which was relevant to the honest and reliable test that was the knowledge of the Applicant for this purpose. In considering these arguments we bear in mind that Mr Reade was introduced to Mr Manning by a reputable New York law firm. Mr Reade was not the client of the Applicant; the clients were the overseas companies which Mr Reade introduced to the Applicant. Mr Jones of the Applicant made enquiries into the overseas companies and prepared all the documentation in connection with the overseas companies. All the issues of concern were connected with the overseas companies and not Mr Reade. The Authority produced no evidence to suggest that Mr Reade's activities or his relationship with the overseas companies made him an unsuitable person to introduce business to the Applicant. Also, on the evidence before us we are unable to conclude that Mr Reade knew that the commissions paid to Mr Manning were secret commissions. Finally, the fact that Mr Manning retained the commissions did not, in our view, affect the way in

which Mr Jones advised the overseas companies. We conclude that the fact that Mr Manning knew that Mr Reade was prepared to pay commissions did not itself give the Applicant reason to doubt that the overseas companies would treat investors in the United Kingdom in an honest and reliable way.

147. Having said that, we record that we are also of the view that the receipt by Mr Manning of the secret commissions may well explain the delay between the date when the Applicant had reason to doubt that Tresaderns and the other overseas companies would deal with customers in an honest and reliable way (mid-November 2003) and March 2004 when the meeting with Mr Reade was held and then June 2004 when the Applicant ceased to act for the overseas companies. But that does not alter our finding that the reason to doubt arose in mid-November 2003 .

Conclusion about issue (2)

148. We conclude that at the outset the Applicant had no reason to doubt that the overseas companies would deal with United Kingdom customers in an honest and reliable way but that by mid-November 2003 the Applicant did have reason to doubt that the overseas companies would treat customers in the United Kingdom in an honest and reliable way.

Issue (3) –Appropriate expertise

149. The third issue is whether that Applicant had arranged for the confirmation exercises (that the promotions complied with the rules) to be carried out by an individual with appropriate expertise within the meaning of COB rule 3.6.1R2.

150. At the relevant time Mr Jones was a solicitor of twenty years standing. He had experience of financial promotions in the United Kingdom through the operation of the Applicant's Entrepreneurs Club. He was the Applicant's compliance officer. He thoroughly researched the regulatory position. He telephoned the Authority for advice. He attended the Authority's seminar. He asked the Authority to advise him specifically about his named clients but they did not do so. He meticulously checked the documents he had to approve and amended them where necessary. There were no complaints about those documents and no complaints about the operation of the escrow account. No investor lost money as a result of the actions of Mr Jones.

151. We conclude that the Applicant did arrange for the confirmation exercises (that the promotions complied with the rules) to be carried out by an individual with appropriate expertise, namely Mr Jones.

Issue (4) – Due skill, care and diligence

152. The fourth issue in the reference is whether the Applicant conducted its business with due skill, care and diligence within the meaning of Principle 2.

153. The Authority raised two matters relevant to this issue, namely, the adequacy of the enquiries made by the Applicant into the overseas companies and whether the Applicant should have advised the overseas companies about the legality of the telephone calls they made to the United Kingdom investors.

The adequacy of the enquiries

154. We have already held that the "no reason to doubt" rule does not impose any obligation to make enquiries but the adequacy or otherwise of the enquiries made by the Applicant about the overseas companies could be relevant in the context of Principle 2. Here we accept the evidence of Mr Jones that the reason that he made enquiries was to comply with Law Society rules and also for the benefit of the Applicant to make sure that the firm was not getting involved with clients they did not want.

155. In our view the work done in making the enquiries could have been improved. Letters should have been sent to the referees named for Condor. Enquiries should have been made as to why Tresaderns had registered its principal activity as advertising. The request for details of the qualifications of the staff of Benjamin Fisher should have been pursued and Mr Hamburger of Rosenhof should have been asked to supply a second personal reference.

156. However, we bear in mind that, as well as asking for documents, the Applicant knew that the overseas companies had been recommended by Mr Reade who in turn had been recommended by a reputable New York law firm. Mr Jones also spoke to the representatives of the overseas companies on the telephone and the Applicant knew that the overseas companies had agreed to the operation of the escrow account which represented a substantial safeguard for investors. It is also relevant that there was no guidance from the Authority to assist the Applicant in this area and the Authority's seminar attended by Mr Jones did not address this issue.

157. Accordingly we conclude that, on balance, as far as the enquiries were concerned, the Applicant did conduct its business with due skill, care and diligence. There was also a question raised at the hearing as to whether the secret commissions paid to Mr Manning influenced him in not pursuing some of the enquiries but we do not have sufficient evidence to make a finding on this matter.

The legality of the telephone calls

158. The Authority argued that the Applicant had wholly failed to consider the legality of the telephone calls made by the overseas companies to investors and the application of sections 21 and 22 of the 2000 Act and of Financial Promotions Order and the Regulated Activities Order.

The Financial Promotions Order

159. We have already referred to section 21 of the 2000 Act, subsection (1) of which provides that a person must not, in the course of business, communicate an invitation or inducement to engage in investment activity unless he is an authorized person or unless the content of the communication is approved by an authorized person. Section 21(5) provides that the Treasury might, by order, specify circumstances in which subsection (1) does not apply.

160. Under the provisions of subsection (5) the Treasury made the Financial Promotions Order. The Order has since been revoked but was in force at the relevant time. Part VI (Articles 27 to 73) exempted certain communications from the operation of section 21 and Article 33 provided that, if certain conditions were met, the financial promotion restriction did not apply to an unsolicited real time communication which was made by an overseas communicator from outside the United Kingdom in the course of his carrying on relevant investment activities outside the United Kingdom. One of the

conditions was that the overseas communicator believed on reasonable grounds that the recipient was sufficiently knowledgeable to understand the risks associated with engaging in the investment activity to which the communication relates.

161. In this reference the content of the written communications was approved by the Applicant but the content of the telephone calls from the overseas companies to the investors was not approved and, indeed, was not capable of being approved by the Applicant under the Conduct of Business Rules. Thus although the Applicant could not approve the content of the telephone calls the question arises as to whether it should have advised its clients (the overseas companies) about the legality of these calls.

162. The Authority argued that the telephone calls came within the prohibition in section 21 and were not saved by Article 33 of the Order; the Applicant argued that the calls were saved by Article 33. If the Authority is right then the overseas companies have committed a criminal offence. Neither party asked us to rule on that matter which in any event we would and could not do. But the Authority argued that the Applicant should have advised the overseas companies about section 21 and the failure to do so amounted to a failure to conduct its business with due, skill, care and diligence within the meaning of Principle 2.

163. We note that when Mr Rycott met the Applicant in January 2003 it was clear that Mr Rycott had undertaken his own research into the 2000 Act and the Rules and was not seeking advice from the Applicant on them. We accept the evidence of Mr Jones that he did consider Article 33 of the Financial Promotions Order, parts of which he copied into the engagement letters to the overseas companies and other parts of which were inserted into the terms and conditions which were approved as an enclosure to the initial letters to be sent by the overseas companies to the investors.

164. We are of the view that we cannot reach a decision on the extent of the Applicant's obligations to advise the overseas companies without deciding whether the Financial Promotions Order did in fact apply to the overseas companies and we were specifically invited not to decide this.

The Regulated Activities Order

165. Section 21(8) of the 2000 Act provides that the words "engaging in investment activity" meant entering or offering to enter into an agreement the making or performance of which by either party constituted a controlled activity and subsection (9) provides that an activity was a controlled activity if it was of a specified kind or specified class. Section 22 of the 2000 Act provides that an activity was a regulated activity if it was an activity of a specified kind and "specified" meant specified in an order made by the Treasury.

166. Under the provisions of section 21(5) and section 22 the Treasury made the Regulated Activities Order. The Order has since been revoked but was in force at the relevant time. Specified activities were defined in Part II (Article 4 to 72A) of the Order. Article 4 provided that the following provisions of that part specified kinds of activity for the purposes of section 22 of the 2000 Act. Article 14 provided that dealing in investments as principal was a specified kind of activity. Article 72 provided that an overseas person did not carry on an activity of the kind specified by article 14 by entering into a transaction as principal with a person in the United Kingdom if the

transaction was the result of a legitimate approach. Article 72(7) provided that "legitimate approach" meant an approach made to the overseas person which had not been solicited by him in any way which did not contravene section 21.

167. The Authority accepted that the application of these provisions was not entirely straightforward and did not argue that they were relevant in the present reference. They did, however, argue that it was a matter which should have been considered by the Applicant.

168. We accept the evidence of Mr Jones that he was familiar with the terms of the Order and considered it within the context of the overseas companies. We are of the view that, if the provisions of the Regulated Activities Order were relevant to the telephone calls made by the overseas companies, then the Applicant should have considered advising them about such provisions but the Authority did not persuade us that the Order was relevant. The failure to give advice about a provision that is irrelevant does not mean that the Applicant did not conduct its business with due skill, care and diligence.

Conclusion about issue (4)

169. We conclude that the Applicant did conduct its business with due skill, care and diligence.

(5) Was the penalty excessive?

170. The fifth issue is whether the amount of the penalty was excessive.

171. As far as the level of the penalty is concerned the Authority argued that the Applicant recklessly ran the risk that it was breaching its regulatory duties and even if not reckless was grossly negligent. The Authority suggested that we might wish to defer our consideration of the amount of the penalty until after we had published our findings on the first four issues. The Authority also argued that it was arguable that the secret commissions received by Mt Manning were partnership property, even if undisclosed, and that could affect the amount of the penalty. This latter argument was repeated in a letter from the Authority dated 28 June 2007 received after the conclusion of the hearing.

172. We do not agree that the Applicant acted negligently or recklessly; everything it did was done as a matter of considered judgment. It will be clear from the findings that we have already made that the only area in which we disagree with the Applicant is as to when there was a doubt that Tresaderns and the other overseas companies would treat investors in an honest and reliable way. We are of the view that such doubt should have occurred in mid-November 2003 when the Applicant should have ceased to act for Tresaderns until the Applicant had been reassured that sufficient changes had been made in their compliance procedures. The subsequent revelations about the secret commissions received by Mr Manning do not alter this view. It may well be, however, that the existence of the secret commissions explained the delay in arranging the meeting with Mr Reade which otherwise might have taken place earlier than 24 March 2004.

173. In considering the amount of the penalty we have borne in mind that the Applicant did not receive the advice and help that could have been given by the

Authority. We have also borne in mind that, when the doubt arose, legal advice was taken, a meeting was arranged with the overseas companies to discuss concerns, a new code of compliance was proposed, and arrangements for the monitoring of the telephone calls made by the overseas companies was also proposed. All these arrangements were appropriate and it was unfortunate that the meeting did not take place earlier than March.

174. Accordingly, in principle we would reduce the penalty imposed by the Authority to reflect our findings. On the basis that the profit made by the Applicant from the work done for the overseas companies was £29,975, and that the Applicant also received £15,073.22 as interest on the monies in the escrow account, we would reduce the penalty from £150,000 to £70,000.

175. However, as the amount of profit received by the Applicant for the work done for the overseas companies is relevant to the amount of the penalty that in turn raises the question as to whether the secret commissions received by Mr Manning should be treated as profits of the Applicant. The revelations about the secret commissions emerged at a very late stage of the hearing and we did not hear detailed argument from both parties on this matter. We therefore defer our final decision about the amount of the penalty until we have heard further submissions from both parties on the subject of whether the secret commissions should be treated as profits of the Applicant for the purpose of determining the amount of the penalty.

Decision

176. Our decisions on the issues for determination in the reference are:

(1) that the Applicant did take reasonable steps to ensure that the promotions were clear, fair and not misleading;

(2) that the Applicant initially did not have reason to doubt that the overseas persons would deal with customers in the United Kingdom in an honest and reliable way; however by mid-November 2003 the Applicant did have reason to doubt and, in our view, should then have ceased to act until the doubts had been removed;

(3) that the Applicant did arrange for the confirmation exercises (that the promotions complied with the rules) to be carried out by an individual with appropriate expertise;

(4) that the Applicant did conduct its business with due skill, care and diligence; and

(5) that we invite further submissions on the subject of whether the secret commissions paid to Mr Manning should be treated as profits of the Applicant for the purpose of determining the amount of the penalty.

Directions

177 **WE DIRECT** that any further submissions on the subject of whether the secret commissions paid to Mr Manning should be treated as profits of the Applicant for the purpose of determining the amount of the penalty should be sent to the Secretary of the

Tribunal within thirty days of the date of the release of this Decision. The Tribunal will then consider whether a further hearing should be arranged. If no submissions are received then the Tribunal will determine the reference on the basis that the penalty is reduced to £70,000.

178. Section 133(5) of the 2000 Act provides that, on determining a reference, the Tribunal must remit the matter to the Authority with such directions (if any) as the Tribunal considers appropriate for giving effect to its determination. We will remit this matter to the Authority after considering any further submissions we receive about the amount of the penalty.

DR A N BRICE

CHAIRMAN

RELEASE DATE

FIN/2006/0015
20.09.07

This Decision was released to the parties on 24 September 2007.
This version corrects clerical mistakes and accidental omissions under rule 28(3).

DR A N BRICE

CHAIRMAN

RELEASE DATE

FIN/2006/0015
05.10.07