responsible for 'macro-prudential oversight' of the financial services system. For instance, s 3 of the Act inserts a new s 9(c) into the Bank of England Act 1993, which brings 'systematic risks attributable to structural features of financial markets' to the future agenda of the FPC. It is intended that the **(p. 720)** FPC will make use of Bank of England's expertise and experience to make independent decisions, free of undue political influence. Where the FPC disagrees and does not act in accordance with the recommendations of the Treasury, however, the FPC will be required to set out its reasons for taking such course of action.

At the same time, the Prudential Regulation Authority (PRA) has been created as a subsidiary of the Bank of England, and is charged with adopting a 'micro-prudential approach' in order to regulate firms which manage significant risks, and thus it is expected to harness the 'safety and soundness of individual firms'. The PRA is expected to intervene where necessary so as to ensure that firms satisfactorily address possible solvency and systemic risks, and mitigate costs that could otherwise be brought to their clients and the public in general.

Finally, outside the Bank of England structure, the Financial Conduct Authority (FCA) has been created. It is to act as the regulator of business conduct. This means that the FCA will be responsible for dealing with an extensive range of issues, from encouraging effective competition, to protecting consumers and providing for transparency, disclosure and access to information.

Overall, the spirit of these reforms places judgement and expertise at the heart of the financial regulatory regime. The aspiration is that these new regulators will take a more proactive and preventive role, in lieu of the 'box-ticking approach' evident in the lead up to the financial crisis. It remains to be seen, however, whether these reforms will be effective in instilling a new regulatory culture, and whether the new regulators are indeed able to take and maintain a hard line against some of the biggest financial institutions in the world. Perhaps the biggest challenge facing the new structure is how the elements will coordinate as between themselves so as to achieve a clear demarcation of functions and duties.

Transparency obligations: investigation and notification of major voting shareholdings in certain public companies

The Transparency Directive

The register of members of a company does not necessarily reveal the true identity of its shareholders: nominees often hold shares for unnamed beneficial owners. The Transparency Directive (2004/109/EC) replaces earlier Directives (and corresponding provisions in CA 1985) and makes detailed provision for disclosure of substantial interests in the shares of public companies that are traded on regulated markets (ie not all public companies—see 'Company investigations into share ownership and the disclosure register', pp 722ff). The object of these measures is to enable both the company and the market to know who has a controlling interest, or who may be in a position to acquire such an interest in the company. More particularly, they enable a close eye to be kept on those who might otherwise obtain control without adhering to the principles laid down in the City Code on Takeovers and Mergers (see 'Takeovers', pp 753ff).

The Directive also makes provision for the periodic financial disclosures that must be made by issuers admitted to trading on a regulated market.

Substantial holdings

The new Transparency Directive was implemented in the UK on 20 January 2007, and responsibility for major shareholding disclosures moved from the Department of Trade and Industry (DTI) (as BIS previously was, several iterations ago) to the FSA (and now to the FCA). According to the Directive, a notification requirement is triggered when the size of a **(p. 721)** shareholder's voting holdings reaches, exceeds or moves below certain thresholds stated in the Directive (5%, 10%, 15%, 20%, 25%, 30%, 50% and 75%). The shareholder is required to inform the issuer, and the issuer must then inform the market.

In preparation for this implementation, CA 2006 s 1266 inserted seven new sections into FSMA 2000 (ss 89A–89G). These new sections enabled new rules to be made by the FSA to implement the Directive. The UK's new

rules, the Disclosure and Transparency Rules (DTR), Ch 5, go beyond those required by the Directive, in that the notification thresholds are tighter (3% then +/–every 1%), the range of issuers subjected to the disclosure obligations is more extensive (including both regulated markets and prescribed markets (such as AIM and PLUS)), and the time limitations for notification are stricter. These tighter rules substantially repeat the rules previously contained in CA 1985.

The thresholds and resulting notification requirements are subject to some practical exemptions and modifications:

(i) clearing and settling—shares acquired for the sole purpose of clearing and settlement within the usual short settlement cycle will be exempt from the requirement to notify;
(ii) custodians—shares held by custodians in their custodian capacity will not be required to notify, provided that they can only exercise the voting rights attached to such shares under instructions given in writing or electronically;
(iii) market makers—market makers are exempt from the 5% threshold when acting in the capacity of market maker. This is provided that they are authorised under the Markets in Financial Instruments Directive (MiFID) (2004/39/EC) and do not intervene in the management of the issuer or exert any influence on the issuer to buy back shares or back the share price;
(iv) Investment Management Companies—the parent undertakings of management companies, as defined by the Transparency Directive, are not required to aggregate their holdings with those of their controlled undertakings. This is provided that the controlled undertaking exercises the voting rights independently from the parent.

Since the sections are concerned with questions of control, it is only voting shares that are affected, but in assessing this both options and rights convertible into shares are also covered (see s 1266, inserting s 89F into FSMA 2000).

In October 2011, the European Commission put forward proposals to amend the Transparency Directive. These seek to cure the 'notification gap'. They will mandate the disclosure of 'major holdings of certain types of financial instruments' that can be used to acquire economic interests in the subject listed companies. It is anticipated that even those who do not acquire the actual shares themselves may become subject to the disclosure requirements so as to prevent 'possible market abuse situations, low levels of investor confidence and the misalignment of investor intentions with long-term interests of companies'.[8]

Consequences of infringement of transparency obligations

If the FCA discovers that an issuer of securities admitted to trading on a regulated market (but not, it seems, other markets) has failed to comply with the various transparency rules, it may publicly censure the issuer (after a warning notice) and/or suspend or prohibit trading in the securities (s 1268, inserting ss 89K and 89L into FSMA 2000).

(p. 722) Liability for false or misleading statements concerning the transparency rules

The primary liability of issuers and directors for the accuracy of the required disclosures lies in criminal and administrative penalties under CA 2006 Pt 15 and FSMA 2000 Pt VI. In addition, restitution can be ordered by the court on the application of the FCA or the Secretary of State under FSMA 2000 s 382, or directly by the FCA under FSMA 2000 s 384.

CA 2006, through FSMA 2000, now also establishes a regime for civil liability to third parties in respect of disclosures that are made public in response to the transparency rules (including periodic financial disclosures) by issuers admitted to trading on regulated markets (CA 2006 s 1270 inserts ss 90A and 90B into FSMA 2000). The aim of this provision is to reduce the legal uncertainty as to whether any actionable duty is owed by issuers and their directors to investors. The section is intended to ensure that the potential scope of any civil liability is reasonable, and that the duties owed to investors are not extended unnecessarily, so that there is some protection for company members, employees and creditors. Clearly, however, there is some doubt about the potential impact of the new section, and FSMA 2000 s 90B enables the provision on liability to be amended if a

wider or narrower civil liability regime is deemed appropriate. The 2007 *Davies Review of Issuer Liability* proposed that issuers' liability to investors for breaches of their continuing disclosure obligations should be limited to cases where those responsible for the misstatement to the market had known that the statement was false, or were reckless in regard to its potential falsity, and where the claimant acted in reliance on the information in question.[9]

This new civil liability regime leaves undisturbed any other liability owed by directors to the issuer and to members of the company under UK and any other national law, and any liability under other FCA rules. It also leaves undisturbed any liability of the issuer in respect of any loss or damage arising other than as a result of acquiring securities in reliance on the relevant statement or report.

Company investigations into share ownership and the disclosure register

Although the disclosure obligations just noted are limited to issuers on regulated and prescribed markets, it is possible for every public company to obtain information about the voting control over its shares. Under CA 2006 s 793, a public company is empowered to require a person to inform it whether he or she has, or has had at any time within the past three years, an interest in its voting shares and, if so, to supply information about that interest. The information so obtained must be recorded on the company's register of interests in shares (s 808). These powers apply against anyone, not just to members. And members who themselves hold 10% or more of the voting shares may requisition the exercise of these powers by the company (s 803). For example, the members may want to act if they suspect that the directors are building up a holding behind the shelter of nominees.

These sections serve a different purpose from the automatic disclosure obligations discussed previously. They enable a company to discover the identity of those with direct or indirect voting rights that fall below the threshold for automatic disclosure, and to ascertain the underlying beneficial ownership of shares. To this end, the definition of an interest in shares is exceptionally wide (s 820): it includes the right to acquire or subscribe for shares (ss 824 and 821), and provides for indirect and family interests to be attributed to the same person (s 823).

If a person fails to give the company the information it requests, or gives false information, the person is not only subject to a penalty (s 795), but the company may apply to the court for **(p. 723)** an order directing that the shares be subject to restrictions (s 794) which may in effect freeze the right to transfer the shares and to receive dividends, vote and take advantage of rights offers (ss 797–802), and may even permit the sale of the shares with court approval (s 801). The restriction order can be a particularly effective sanction in the case where holdings of shares are being built up secretly through nominees based overseas, who are not easily made amenable to the local jurisdiction and who may be able to shelter behind laws in their own country which protect the confidentiality of nominee arrangements. The weakness of the sections is, however, that the company must know which of its shares are being affected by the scheme which it supposes to exist.

Disclosure and public offerings of shares

Companies wishing to raise capital may offer their shares for sale to the general public. To do this legally, the company must be a public company. The shares in public companies are often widely held, and individual members are usually more interested in capital and income returns than in close involvement in the management of the company. In order to make a company's shares more attractive to such investors, it is necessary to assure them that the initial sale is conducted on the basis of full and proper information, and that the new shares can easily be sold in the market to liquidate the investment, switch to a new investment or realise the capital gains.

These activities, and others, are regulated by FSMA 2000. This Act replaces the Financial Services Act 1986 and other legislation under which different aspects of the financial services industry were separately regulated by a mixture of public bodies, trade associations and professional institutes. Now there is a single regulator, the FCA, with members of its board appointed by the Treasury. The FCA has to meet four regulatory objectives (FSMA 2000 ss 1–6):

- **(i)** maintaining confidence in the financial system;
- **(ii)** promoting public awareness of the financial system;

(iii) securing the appropriate degree of protection for consumers; and
(iv) reducing the extent to which the financial system can be used to support financial crime.

History

During the nineteenth century (and, indeed, for a considerable period before that), the formation of almost all companies was followed immediately by an appeal to the public to participate in the new venture by joining as members and subscribing for 'shares' in the 'joint stock'. The main reason for 'going public' in this way was to raise funds in the large amounts necessary for the enterprises of the period—often massive operations which built a large proportion of the world's railways, laid submarine cables, opened up trade and investment in distant parts and provided the banking, insurance and other services to support such activities. The promoters of the company would publish a 'prospectus', giving information about the undertaking and inviting subscriptions. This process is often referred to as a 'flotation' of the company or, more accurately, of its securities. Today, big business still has need of funding on a large scale, and this can be sought by the same process of appealing to the public to become investors in the enterprise. But it would be very unlikely nowadays that this would be attempted by the promoters of a new company immediately after its incorporation. The reason for this is that people will usually be prepared to become investors in shares or **(p. 724)** other securities only if they can be readily sold and turned back into cash, more or less at will. To meet this need there must be a 'market', available to all comers, where shares can be bought and sold and prices can fluctuate in response to supply and demand. Access to the share market is virtually indispensable if investors are to be attracted in any large numbers. And rules have been developed by the London Stock Exchange—the body which has for many years controlled the only markets of any significance in the country—which will not normally allow a company's securities to be accepted for dealing on the market unless it has an established business record. For a 'full' or 'official' listing on the Main Market this record must go back for at least three years. The requirements are less demanding, though still quite strict, if the listing is to be on AIM. Responsibility for the formulation of the Listing Rules was an 'in-house' matter for the Stock Exchange until October 1999 (originally, as a matter of self-regulation but later with the blessing of legislation). With the introduction of FSMA 2000, this function was taken over by the FSA and now passes to the FCA by virtue of the Financial Services Act 2012.

Securities markets

Securities markets make it easier for investors to buy and sell securities. These markets are regulated in the interests of investors, since attracting these people will maximise the amount of capital available to the issuers of the securities traded on the market. But this form of regulation imposes costs on the issuers, who must provide information and subject themselves to public scrutiny. The greater the regulation, the greater the cost. Regulators have therefore adopted a variety of regimes, so that the securities of larger, better-known and more stable companies can be traded on highly regulated exchanges, while the securities of smaller, less well-known and riskier companies can be traded elsewhere.

FSMA 2000 s 285 allows investment exchanges to become *recognised investment exchanges* (RIEs). To become recognised in this way, an exchange must have sufficient financial resources, be a 'fit and proper person' and ensure its business is conducted in an orderly manner so as to afford proper protection to investors (including deciding which investments should be 'admitted to trading' and what information should be made available to investors).

Exchanges that are not RIEs must obtain permission under FSMA 2000 Pt IV to carry on regulated activities, and are then subject to lesser regulation than RIEs. These exchanges are called *multilateral trading facilities*, following the transposition of MiFID into UK law in November 2007.

A RIE can operate a '*regulated market*' as defined in the Investment Services Directive (93/22/EEC), Art 16.[10] RIEs and alternative trading systems (ATSs) can also operate '*exchange-regulated markets*' that are regulated by the exchange itself. For example, the London Stock Exchange is an RIE, and it operates a number of markets subject to different regulatory regimes. The most significant are the Main Market, AIM and the Professional Securities Market (PSM). The Main Market is a 'regulated market'; AIM is an 'exchange-regulated market'.

The regulations operate at three levels: (i) at EU level for all securities admitted to trading on regulated markets ('*traded companies*'); (ii) at EU level for any security which is the subject of a public offer; and (iii) at national level (subject to EU minimum requirements) for listed securities on a domestic exchange ('*listed companies*'). In addition, '*quoted companies*' (CA 2006 s 385) are companies officially listed on various specified UK and other exchanges.

The London Stock Exchange's Main Market provides the most expensive and extensive form of regulation for listed securities. A company whose equity share capital is admitted to **(p. 725)** trading on this market is simultaneously listed, traded and quoted. A company whose shares are admitted to trading on AIM is not usually listed, traded on a regular basis or quoted.

Official listing

Official listing is an optional additional regulatory regime for securities markets. There are minimum EU standards for official listing (Listing Directive (2001/34/EC)), but the UK domestic rules (set out in the FCA's Listing Rules) are particularly extensive, and are said to contribute to the sound financial reputation of the London Stock Exchange's Main Market.

EU rules require an issuer to have a demonstrable track record, a certain financial size and a wide enough spread in public shareholdings to create a realistic market. In addition, the rules oblige publication of half-yearly reports. The Listing Rules impose additional obligations, requiring adherence to the Listing Principles, continuing obligations requiring extra information in annual accounts and reports, preliminary statements of annual results, compliance with the Model Code, which restricts dealings in securities by company managers and others, and compliance with the UK Corporate Governance Code (see Chapter 5) (or an explanation of non-compliance).

The FCA may permanently discontinue or temporarily suspend a listing, without notice, if it suspects irregularities that preclude normal dealings in the securities (FSMA 2000 s 77). It may also impose public censure or financial penalties, or launch a public investigation (FSMA 2000 ss 91 and 97).

Prospectuses

As it applies in the UK, the Prospectus Directive (2003/71/EC), implemented by FSMA 2000 Pt VI, provides that, with defined exceptions, whenever there is a public offer of securities or a request for admission of securities to trading on a regulated market, a prospectus approved by the FCA must be published (FSMA 2000 s 85). The prospectus must contain all the information required by investors to make an informed assessment of the securities. A person who contravenes the requirement for a prospectus commits an offence, and is liable to be sued for breach of statutory duty by anyone who suffers loss as a result of the contravention (s 85(3) and (4)).

These rules undergo periodic review. In mid-2010, for example, an Amending Directive (Directive 2010/73/EU) was approved by the European Parliament, and the changes thereof have now been implemented in the UK, through amendments made to the FSMA 2000, which came into force on 31 July 2012. Other changes were also introduced through Prospectus Regulations 2011 (SI 2011/1668) and 2012 (SI 2012/1538). Most of these changes are seen as 'deregulatory', in that they aim to better facilitate the raising of funds and to allow greater legal certainty in the prospectus regime.[11]

When the FCA acts as the competent UK authority for these purposes, it sometimes uses the name United Kingdom Listing Authority (UKLA), and its rules on prospectuses are to be found in the Prospectus Rules Sourcebook (PR) in the FCA Handbook.

Restrictions on public offers by private companies

A private limited company is not permitted to offer its unlisted shares to the public (CA 2006 s 755, and s 756 for the meaning of 'offer to the public'), although an allotment following such an offer is not invalid (s 760).

Exceptions from the prohibition exist where the company acts in good faith in pursuance of arrangements to re-register as a public company before the shares are allotted, or as part **(p. 726)** of the terms of the offer it

undertakes to and does in fact re-register as a public company (s 755).

The court may make an order restraining the company from contravening the prohibition, order the company to re-register as a public company, order it to be wound up or make a remedial order intended to put a person affected by the contravention in the position he or she would have been in had the contravention not occurred (ss 757–759).

Content of prospectuses

The prospectus must contain all the information required by investors to make an informed assessment of the securities, the rights attaching to them and the status of the issuer (assets and liabilities, financial position, profits and losses and prospects). This must be presented in a form that is easy to analyse and comprehend, and must contain a brief summary in non-technical language containing 'key information' which assists investors in deciding whether or not to invest in the subject securities. A definition for 'key information' is also provided, along with a list of information required thereof (FSMA 2000 s 87A (as amended in 2012)). Once approved in the issuer's home state, the prospectus is valid throughout the EU. This is to facilitate the development of a single European capital market in which an issue of shares can be offered to the public and traded throughout the EU.

If a significant new factor arises, or a material mistake or inaccuracy is noted, between the time of approval of the prospectus and the final closing of the offer of securities to the public or the beginning of trading on a regulated market, then a *supplementary prospectus* must be issued by way of correction (FSMA 2000 s 87G). Where the securities are both offered to the public and are to be admitted to trade on a regulated market, then the relevant period becomes the time of approval to either the closure of the public offer or the time when trading in the regulated market begins, whichever is later (FSMA 2000 s 87G(3A)).

Exemptions from the prospectus requirements

An approved prospectus need not be published if:

(i) the offer of securities is addressed solely to qualified investors (FSMA 2000 s 86(1)(a) and (7));
(ii) the offer of securities is addressed to fewer than 150 persons, other than qualified investors (FSMA 2000 s 86(1)(b) as amended by Prospectus Regulations 2011);
(iii) the total consideration for the offer is less than €5 million, with the exemption applying only once during a 12-month period, and applying on an EU-wide basis (FSMA 2000 ss 85(5)(a), 87, and Sch 11A, para 9);
(iv) the minimum consideration payable by each investor is €100,000 (or its equivalent in another currency), or the nominal value of each security is €100,000 (or its equivalent in another currency)[12] (FSMA 2000 s 86(1)(c) and (d));
(v) the additional shares being offered for trading (and not offered to the public, unless to existing or former directors or employees) are of the same class as existing shares and number less than 10% of those already admitted, with the 10% limit available once every 12 months (FSMA 2000 s 85(6)(b) and (5)(b));
(vi) the offer of securities is in exchange for shares of the same class already issued or admitted to trading, provided there is no increase in issued capital, or if the shares result from conversion or exchange of other transferable securities or from rights associated with such securities (FSMA 2000 s 85(5)(b) and (6)(b));
(p. 727) **(vii)** the offer of securities is in connection with a takeover, merger or division, provided there is another document which the UKLA considers contains equivalent information (FSMA 2000 s 85(5)(b) and (6)(b));
(viii) the offer of securities is by way of bonus shares or shares issued in lieu of a dividend, provided there is a document explaining the offer (FSMA 2000 s 85(5)(b) and (6)(b)); or
(ix) the shares have been admitted to trading on one EU regulated market for more than 18 months, and the proposal is to admit them on another regulated market (FSMA 2000 s 85(6)(b)).

In cases (i)–(iv), although the particular offer is exempt, it may still be necessary to publish a prospectus if the issuer wishes to obtain admission of the securities to trading on a regulated market (and exemptions (v)–(ix) do not apply).

FCA sanctions

The FCA has extensive powers to:

(i) suspend or prevent a public offer of securities, or an application for admission to trading on a regulated market (FSMA 2000 ss 87K and 87L);
(ii) publicly censure or impose a financial penalty (FSMA 2000 ss 87M and 91); or
(iii) instigate an investigation (FSMA 2000 s 97).

Liability for misleading statements and omissions in prospectuses

The primary object of the prospectus legislation (like the Listing Rules) is to ensure that potential investors in companies whose shares are offered to the public or traded on the market are provided with sufficient information to enable them to make informed decisions. Disclosure is the key. But the current legislation sets high standards; it imposes a *general* duty to ensure that the prospectus contains all such information as investors would reasonably require and reasonably expect to find there for the purpose of making an informed assessment of the financial position of the issuing company and the rights attaching to the securities.

If investors suffer a loss as a result of an untrue or misleading statement in, or omission from, a prospectus or supplementary prospectus, then, in addition to the various remedies available under the general rules described at 'Offers to the public to purchase shares and remedies for misleading offers', pp 499ff, certain specific remedies are available:

(i) statutory compensation remedies under FSMA 2000 s 90(1) for losses caused by reliance on any untrue or misleading statements in the prospectus or supplement, or any omissions of matters required to be included by FSMA 2000 s 87A or 87G; or
(ii) statutory remedies under FSMA 2000 s 90(4) for losses suffered in respect of failures to issue necessary supplementary prospectuses as required by FSMA 2000 s 87G.

'Compensation', under FSMA 2000 s 90(1) and (4), is likely to be assessed in the same way as damages for the tort of deceit (see *Clark v Urquhart* [1930] AC 28 in relation to predecessor provisions).

Under the FSMA 2000 provisions, compensation is payable by any person 'responsible for' the misleading prospectus (s 90(1)). This includes the company, every director at the time the prospectus was published (unless published without the director's knowledge or consent, and on becoming aware of it the director gave public notice to that effect as soon as practicable); every person named as being or having agreed to become a director (provided this statement was made with the person's consent); every person named as accepting responsibility for the prospectus (or the relevant specific parts of it); and every person who authorised the **(p. 728)** contents of the prospectus (or the relevant specific parts of it), although giving professional advice does not make a person responsible.

Certain defences are available to these potential defendants, including their own reasonable belief in the accuracy of the information, reasonable reliance on experts, reasonable efforts to effect corrections, or, alternatively, proof of the claimant's knowledge that the relevant statements were false or misleading or that there was a relevant omission (FSMA 2000 Sch 10).

It appears arguable that anyone who has 'acquired' shares, whether as the original allottee or on the market, is able to sue for compensation (FSMA 2000 s 90(1) and (4)). According to the common law, only the original allottees could sue, on the basis that a prospectus was intended for subscribers, not for subsequent purchasers (*Peek v Gurney* (1873) LR 6 HL 377). But Lightman J, in *obiter dicta*, suggested a different and broader approach to the FSMA 2000 provisions, on the basis that prospectuses are now intended to encourage subsequent trading in shares: *Possfund Custodian Trustee Ltd v Diamond* [1996] 1 WLR 1351. The decision is controversial.

Under-subscription for the new issue

Under CA 2006 ss 578–579, a company must not allot any shares unless the issue is fully subscribed or the offer makes it clear that some other conditions are to apply. If the issue is not fully subscribed (or other specified conditions are not met) within 40 days, then the subscribed funds must be returned to the investors forthwith, but

without interest. Interest is payable after 48 days, with the directors becoming jointly and severally liable. Any attempt to contract out of this provision is void. If an allotment is made in contravention of this section, then the allottee may rescind the allotment within one month even if the company is in the course of being wound up.

Both the company and any allottee can recover any loss or damage sustained as a result of the contravention from any director who knowingly committed, permitted or authorised the contravention.

Market abuse: insider dealing and market manipulation

Controlling market abuse

Market confidence exists only if traders believe that market prices reflect the true value of what is bought and sold. Correct pricing is more likely if both buyers and sellers have all the relevant information to hand. Public confidence in the market is easily damaged if people close to the company use 'inside information' about the company to revalue the shares ahead of the market, and trade on that privileged basis (this is known as '*insider dealing*'). Public confidence is also damaged if false information about the value of shares is spread, creating a false market (this is known as '*market manipulation*').

Control of these forms of market abuse on regulated markets is required by the Market Abuse Directive (2003/6/EC),[13] and is implemented in FSMA 2000 Pt VIII (which extends to all markets operated by RIEs) by:

(i) penalising insider dealing and market manipulation;
(p. 729) **(ii)** requiring insiders to declare their trading; and
(iii) requiring companies to disclose price-sensitive information promptly to the market.

If the FCA discovers that a person has engaged in market abuse (on the balance of probabilities), it may request the court to issue an injunction restraining the activity, or order restitution or some form of mitigation, or issue a freezing injunction preventing the person dealing with his or her assets (FSMA 2000 ss 381 and 383–384). Alternatively, the FCA itself may impose a financial penalty or publicly censure the individual (FSMA 2000 s 123). The imposition of a penalty does not make the transaction void or unenforceable (FSMA 2000 s 131).

Insider dealing

There has been much interest in the past few decades in the topic of '*insider dealing*' or '*insider trading*'. These terms are used to describe the use (or, rather, the misuse) of confidential information by people who, as company officers or employees or as civil servants, avail themselves of knowledge which they acquire in the course of their work, or by reason of their office, to deal to their own profit in a company's securities. Most people regard this practice as unfair in itself and damaging to the confidence of investors in the integrity of the share market.

Insider dealing: common law protection

Until 1980, the only constraints available to deal with insider trading were those imposed extra-legally by the self-regulatory agencies of the City, and in particular by the Takeover Panel, and the possibility that there might be civil liability in at least some cases. It seemed that decisions like *Regal (Hastings) Ltd v Gulliver* **[7.23]** and*Boardman v Phipps* [1967] 2 AC 46 (see Note 1 following *Peso Silver Mines Ltd v Cropper* **[7.32]**, p 404) might be used as authority for making directors, and others similarly placed, liable to account to their company for any profit that they made, and indeed that is very much what happened in *Regal*. There was also the possibility of some form of liability for breach of confidence as an equitable remedy in its own right (*Seager v Copydex Ltd* [1967] 1 WLR 923). But all these possible claims are open to the criticism that in most insider dealing cases the company is not the real loser, and may have no incentive to pursue the wrongdoer. *Percival v Wright* **[7.05]** seems to bar the development of a claim based on breach of duty between the director (or other 'insider') and the person to whom he or she has sold or from whom he or she has bought the shares. However, there have been hints in cases such as *Coleman v Myers* ([1977] 2 NZLR 225) that a civil remedy for victims of insider trading could be developed, similar to that which has evolved in the United States through such cases as *SEC v Texas Gulf Sulphur Co* 401 F 2d 833 (1968) and *Diamond v Oreamuno* 24 NY 2d

494 (1969) (though the authority of the latter is questionable, since it was not followed in the company's home state, Florida: see *Schein v Chasen* 313 So 2d 739 (1975)).

All these questions centred on possible civil liability for insider dealing remain live issues, but they have had less of the limelight since 1980, when successive legislative provisions established both criminal and civil penalties for those guilty of the offences of insider dealing as there defined. Nevertheless, they remain important in cases where the statutory provisions do not apply (eg in cases of dealings in shares of private companies).

Insider dealing: statutory civil protection (FSMA 2000 s 118)

FSMA 2000 Pt VIII protects prescribed markets, being all regulated markets and markets operated by RIEs (and, under legacy provisions operating until 2008, all markets operated by UK RIEs and PLUS) (FSMA 2000 s 130A). Within these markets, it protects against three forms of insider dealing (FSMA 2000 s 118): dealing by an insider (s 118B) on the basis of inside information (s 118C) relating to the investment in question (*insider dealing*); improper disclosure **(p. 730)** by an insider otherwise than in the proper course of his or her duties (*improper disclosure* or *tipping*); and (only until 2008, under the legacy provisions) use by anyone of information not generally available (*misuse of information*).

Insider dealing: criminal protection (Criminal Justice Act 1993 Pt V)

The definitions of regulated market, inside information and insider dealing are all slightly different under the 1993 Act from the rules adopted in FSMA 2000. Within these definitions, and subject to limited exceptions, insiders cannot deal in the relevant securities, encourage others to deal, or disclose inside information to others. On indictment for an offence, the penalty can be imprisonment for up to seven years, and/or a fine for which there is no limit (Criminal Justice Act 1993 s 61(1)). Criminal proceedings may only be instituted by the FCA (FSMA 2000 s 402), or by, or with the consent of, either the Secretary of State or the Director of Public Prosecutions (Criminal Justice Act 1993 s 61(2)). A transaction entered into in contravention of the Criminal Justice Act 1993 is neither void nor voidable (s 63(2)), although, being illegal, it is unlikely to be enforced by any court.

Market abuse

FSMA 2000 s 118 identifies six forms of market manipulation as market abuse, all of which have the capacity to distort the market price of the relevant securities. The FCA provides some safe harbours for practices regarded as proper (eg company share buy-backs, or a public authority's pursuit of monetary or exchange rate policies).

The civil penalties for such conduct were outlined earlier (see 'Liability for false or misleading statements concerning the transparency rules', p 722). In addition, FSMA 2000 s 397 makes creating a false market a criminal offence,[14] subject to certain statutory defences (s 397(3) and (5)).

For a recent illustration on the working of the market abuse provisions, see *David Massey v The Financial Services Authority* [2011] UKUT 49 (Tax and Chancery Chamber).

Public investigation of companies

The past 50 years have seen a continuing increase in the involvement of government in the affairs of companies. This reflects a long-held recognition that abuse of corporate power is unlikely to be adequately constrained by leaving all regulation and litigation to the company's members. It is further evidence of the loss of privacy that comes with limited liability. That said, the UK is one of the few jurisdictions to go further and provide for more controversial inspectorship provisions, allowing investigation of companies' affairs by the Companies Investigations Branch (CIB) of the Department for Business, Innovation and Skills (BIS), and providing for extensive powers to collect evidence and pass it on to regulatory or prosecuting authorities.

These powers of the Secretary of State to appoint inspectors to investigate the affairs of companies under CA 1985 Pt XIV (not transported to CA 2006, although CA 2006 ss 1035–1039 introduced certain amendments) may seem of little significance in comparison with the various forms of regulation ensuring control of fair practices,

unfair competition, mergers and monopolies, takeovers (and mergers effected by takeover), and so on. Nevertheless, the possibility of such public investigation of companies sets them apart from individuals and partnerships. **(p. 731)** Investigations may be launched into the affairs of companies (CA 1985 ss 431 and 432) or into the membership and control of companies (CA 1985 s 442).

Powers of investigation

CA 1985 confers powers of investigation of two different kinds. The first is more formal. The Secretary of State may appoint inspectors 'to investigate the affairs of a company and to report on them in such manner as he may direct' (CA 1985 s 431(1)). The appointment may be initiated by the Secretary of State (see later). It may also be initiated on the application of the company itself, or by a requisition having the support of at least 200 members or members holding not less than one-tenth of the issued shares (CA 1985 s 432(2)), but then the applicants must show that they have good reason and be prepared to pay the costs. Not surprisingly, there are few occasions when this has been done. Alternatively, an investigation of this type may be ordered by the court (CA 1985 s 432(1)).

The mere announcement of an inspection is likely to have a substantial and detrimental impact on the company's standing and profit. The powers are therefore used sparingly, and only in the most serious of cases, often after public outcry and extensive media coverage. In the past decade, only five or six investigations have been launched, often with long and expensive consequences. For example, the Mirror Group Newspapers trials lasted nine years and cost £9.5 million.[15]

Inspections are most commonly initiated by the Secretary of State. This may be done if the Secretary of State considers there is fraud or other improper conduct, or that the company's members have not been given all the information that they might reasonably expect (CA 1985 s 432(2)); or it is necessary to ascertain where the true ownership of shares or debentures or control of the company actually lies (CA 1985 s 442); or there has been insider dealing (FSMA 2000 s 168(3), also allowing the FCA to initiate such investigations).

In a straightforward case the inspectors may be officers in the Secretary of State's own department, but, for the more serious cases, it is usual to appoint a QC and a leading accountant. The report may be published, and usually is if the matter is one that has attracted public interest.

The second form of power held by the Secretary of State is lower key, allowing for an informal, unpublicised inquiry, requiring a company to produce specified documents for inspection by his officers or some other competent person, or, if they are not in its possession, to state where it believes they are (CA 1985 s 447). Failure to comply may be punished as contempt of court. This latter power (which avoids much expense and publicity) can be used alone, but is often used as a first step, before a decision is taken whether to set up a full-scale investigation under CA 1985 s 432(2). Use of this power is controversial. Many complain that the exercise is as detrimental, probing and traumatic as a formal inspection, yet often reveals no cause for follow-up. In 2005/2006, 3,702 companies were named in requests, but formal investigations were started in only 148 cases (ie in approximately 4% of cases). The investigations rarely concern the accountability of management to members, but almost always focus on fraudulent trading, theft, breach of disqualification orders and undertakings, and such like.

An investigation may lead to a number of consequences. If criminal conduct is revealed, or suspected, the inspectors' findings may be followed by a prosecution. The Secretary of State may apply for disqualification orders against directors and other persons involved in the management of the company (Company Directors Disqualification Act 1986 (CDDA 1986) s 8), or for the winding up of the company (Insolvency Act 1986 (IA 1986) s 124A), or for a remedy under CA 2006 s 995. Under CA 1985 s 438, the Secretary of State could institute proceedings **(p. 732)** for a civil remedy in the name of the company, but this provision has since been repealed under CA 2006 s 1176. Documents and information obtained during the investigation may be disclosed to regulatory authorities; comparable powers may also be used to assist certain overseas law enforcement and regulatory authorities (Companies Act 1989 (CA 1989) ss 82ff). If satisfactory information about the ownership or control of a company is not forthcoming, this may lead to the imposition of a 'freezing' order on the shares in question (CA 1985 s 445; see 'Company investigations into share ownership and the disclosure register', p 722).

Conduct of the investigation

The cases that follow illustrate aspects of the working of the investigatory powers in practice.

In reaching a decision whether to appoint inspectors to investigate the affairs of a company, the Secretary of State is not bound by the rules of natural justice.

[14.01] Norwest Holst Ltd v Secretary of State for Trade [1978] Ch 201 (Court of Appeal)

The facts appear from the judgment.

> LORD DENNING MR: Ever since 1948 there has been a valuable provision of the Companies Act by which the Board of Trade can appoint inspectors to investigate the affairs of a company. Many investigations have been held by inspectors, usually one of Queen's Counsel, and the other an accountant. In a case we had fairly recently, *Re Pergamon Press Ltd* **[14.02]**, we had to consider the position of the inspectors under such an inquiry. It was held by this court that the inspectors were under a duty to act fairly in the conduct of their inquiry.
>
> Now we have to consider a different point. It is said that the minister himself has done wrong. His conduct is challenged. It is said that the minister has acted beyond his powers in appointing inspectors. He ought, it is said, to have warned the company beforehand and given them a chance of being heard. Furthermore, it is said that the minister exercised his discretion erroneously. He ought to have had sufficient reasons, and he had none in this case. It is said further that he is acting on the information of informers, which is inadmissible as being against the public interest.
>
> On these grounds the company has brought an action to try to stop the inspectors proceeding with the inquiry. The minister applied to strike it out. Foster J struck it out. The company appeal to this court …
>
> On 11 March 1977, the Secretary of State ordered the inquiry now in question. He did it under s 165(b)(ii) of the Companies Act 1948 [CA 1985 s 432(2)]. On 25 March 1977, the secretary of the group wrote:
>
>> I am authorised to say that it does not appear to my board that there are any circumstances which would justify the exercise of your discretionary power under the section to appoint inspectors.
>
> He asked: What were the circumstances? Would they be disclosed? The Secretary of State declined to give that information …
>
> As the minister gave no information, the company started this action. They delivered a statement of claim, which they afterwards amended. The burden of the statement of claim is that the company know of no wrongdoing which has been done by them or any of their people; and therefore it is wrong that the minister should appoint inspectors without, as they say, any proper justification. They put it in these words in their final amended pleadings:
>
>> … It is implicit in the provisions of s 165(b)(ii) of the said Act that the discretionary power to appoint inspectors is to be exercised fairly and/or in accordance with the principles of natural justice.
>
> **(p. 733)** They ask for a declaration that the appointment or purported appointment was ultra vires and invalid.
>
> It is important to know the background of the legislation. It sometimes happens that public companies are conducted in a way which is beyond the control of the ordinary shareholders. The majority of the shares are in the hands of two or three individuals. These have control of the company's affairs. The other