

# Compliance Monitor

The monthly briefing service for compliance specialists

## Knocking in the pipes

On 16 May the Financial Services and Markets Tribunal issued its decision in the long running case of *Paul Davidson and Ashley Tatham v FSA*. The Tribunal decided that Mr Davidson (also known as “the Plumber”) and Mr Tatham were not guilty of market abuse under section 118 of the Financial Services and Markets Act 2000 (FSMA). **Andrew Hart** and **Oliver Kerridge** of Freshfields review the Tribunal findings and the connotations for future proceedings.

### The facts

Mr Davidson was a majority shareholder of a company called Cyprotex PLC, which, in February 2002, was due to be floated on AIM. Nigel Howe (also known as “the Spaniard”) was an employee of the nominated broker in charge of the placing. The take up of shares in the placing was slow and, on the account of Mr Davidson, Mr Howe placed a large spread bet with City Index of which Mr Tatham was the executive director of trading. City Index hedged the bet with Dresdner Kleinwort Wasserstein Securities, which, in turn, hedged its exposure by purchasing Cyprotex shares in the placing. The placing was thereby filled.

In October 2003, the FSA issued a Decision Notice against Mr Davidson, Mr Howe and Mr Tatham imposing penalties against them of £750,000, £300,000 (reduced to £50,000) and £100,000 respectively. The fines were imposed because the FSA considered that the conduct of the individuals constituted market abuse under section 118 FSMA in that their actions were likely to give a false or misleading impression as to the demand for and value of Cyprotex shares. Mr Davidson was not an approved person at the time but Mr Howe and Mr Tatham were. Accordingly, the FSA considered that Mr Howe had breached Principles 1 (integrity), 2 (due skill, care and diligence) and 3 (failure to observe proper standards of market conduct) and that Mr Tatham had breached Principles 2 and 3.

### The Tribunal's Decision

Although the Tribunal considered that in Mr Howe's mind there was a scheme of arrangement to facilitate the

flotation of Cyprotex, it held that Mr Davidson and Mr Tatham had not engaged in market abuse. Firstly, the Tribunal considered that there was no regulatory obligation to disclose the spread bet or contract for differences in the Cyprotex Prospectus and so a failure to do so did not constitute market abuse. Secondly, Mr Davidson and Mr Tatham were not found to be complicit in the scheme of arrangement. Mr Davidson was believed to know little about spread betting or the hedging that was likely to result and had not placed the bets himself. Mr Tatham believed that the spread bets were being placed in the belief that Cyprotex's share price would rise. Finally, even if Mr Davidson and Mr Tatham had been complicit in the scheme, they had made full disclosure to the nominated broker, Mr Howe, whose responsibility it was to make full disclosure to the Nomad (nominated adviser) and to the board of Cyprotex.

### Commentary

The Tribunal's decision in this case follows the recusal of the Tribunal after an improper conversation between a member of the previously constituted Tribunal and the then Chairman of the Regulatory Decisions Committee. The Tribunal has also recently overturned an FSA decision to impose penalties on Timothy Baldwin and WRT Investments Limited for market abuse. This decision has therefore caused further embarrassment for the FSA which still is awaiting market abuse decisions from the Tribunal in respect of Philippe Jabre (formerly of GLG Partners) and James Parker (former group credit and risk manager at Pace Micro Technology).

Various points of interest arise from the Tribunal's decision:

### Standard of proof

The Tribunal ruled that, contrary to the FSA's view, market abuse charges were criminal for the purposes of Article 6 of the European Convention on Human Rights. Despite this, the standard of proof to be applied in

market abuse cases is the civil one (on the balance of probabilities) and not the criminal one (beyond all reasonable doubt). Given the severe nature of the penalties in question, however, a heightened civil standard of proof was necessary which would be likely to produce the same or similar results as the criminal burden of proof.

### Reliability of witness evidence

The reliability of witness evidence in the Tribunal will always be an issue, especially in market abuse cases where the intentions of the parties tend not to be reflected on paper but in conversations that they had. In cases such as this one, where witnesses were questioned about events that occurred in 2001 and 2002, the Tribunal accepted that it was understandable if there was some uncertainty as to what happened and that such confusion should not undermine the credibility of the witnesses. Coupled with the heightened standard of proof, this is likely to make the FSA's task more difficult in future market abuse cases.

### Penalties

Fines for market misconduct have been substantially higher than penalties for breaches in other areas. For example, the highest fine imposed on a corporate/firm remains Shell's penalty of £17m and the highest fine to date imposed on an individual is £350,000. In her speech on enforcement priorities and issues for 2006,

Margaret Cole, the FSA's director of enforcement, stated that perpetrators of market misconduct could expect to receive higher penalties. Ms Cole explained that larger fines would act as a deterrent and reflect the FSA's dim view of such behaviour. The Tribunal took the interesting step of considering what penalties would have been appropriate had Mr Davidson and Mr Tatham been found to have engaged in market abuse. It concluded that the appropriate penalty would have been a censure and not a fine. This was because: both individuals had cooperated; no remedial action was required; there was no precedent for a fine; and the other places were institutional investors and were unlikely to have suffered losses. It will be interesting to see what the Tribunal has to say about Philippe Jabre's proposed fine of £750,000.

### Criminal prosecutions

Finally, although the FSA is now concentrating on market abuse cases and the penalties that it is imposing in this area tend to be larger than the average, it has brought few criminal prosecutions. This may be due to the time and costs of bringing a criminal prosecution, as was seen with the former directors of AIT.

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