Criminal Justice Act 1993
Insider Dealing Provisions

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CONTENTS

1. INTRODUCTION 1
   1.1 Criminal Justice Act 1993 (the “Act”) 1
   1.2 Financial Services and Markets Act 2000 (“FSMA”) 1
   1.3 The Market Abuse Directive 2
   1.4 Categories of market abuse 2
   1.5 Memorandum on market abuse 3

2. PERSONS AND DEALINGS TO WHOM THE ACT APPLIES 3
   2.1 “Having information as an insider” 3
   2.2 “Inside source” 4
   2.3 “Information” 4
   2.4 “Made public” 6
   2.5 “Significant effect on price” 7

3. OFFENCES 8
   3.1 The dealing offence 8
   3.2 The tipping offence 9

4. DEFENCES 9
   4.1 General defences 9
   4.2 Market makers 11
   4.3 “Market information” 11
   4.4 Price stabilisation 13

5. PENALTIES AND TERRITORIAL SCOPE 13
   5.1 Enforcement and penalties 13
   5.2 Territorial scope 14
6. TRANSACTION DANGERS

6.1 Sector information

6.2 Underwriting: information not in the prospectus

6.3 Bought deals

6.4 Placings

6.5 Disposals of rumps

6.6 Takeovers

6.7 Own share purchases

6.8 Debt to equity exchanges

6.9 Stake building and hedging

6.10 Repos and stock-lending
1. INTRODUCTION

1.1 Criminal Justice Act 1993 (the “Act”)

The Act creates two insider dealing offences. The first offence, the “dealing offence”, is aimed at those who deal in particular kinds of securities and in specified circumstances on the basis of inside information:

An individual is guilty of insider dealing if he has information as an insider and deals, in specified circumstances, in securities which are price-affected in relation to that information.

The second offence, the “tipping offence”, is committed either by disclosing inside information or by encouraging another to deal in particular kinds of securities and in specified circumstances:

An individual is guilty of insider dealing if he has information as an insider and either encourages another person to deal in securities which are price-affected in relation to the information knowing or having reasonable cause to believe that the dealing would take place in specified circumstances or if he discloses the information to another person otherwise than in the proper performance of the functions of his employment, office or profession.

The specified circumstances are that the dealing either occurs “on a regulated market”, or that the person dealing “relies on a professional intermediary or is himself acting as a professional intermediary”.

The extent of each offence depends upon the supporting definitions in the Act.

1.2 Financial Services and Markets Act 2000 (“FSMA”)

On 1 December 2001 FSMA introduced a statutory prohibition on market abuse which supplements the criminal offences of insider dealing and market manipulation.

The reason for the introduction of the regime was the Government’s view that existing criminal and regulatory sanctions (and in particular the provisions relating to insider dealing) did not effectively address all forms of abusive conduct. As a result, the concept of market abuse represented a considerable expansion in the scope of the law. Further, it was widely considered that the criminal law standard of proof was too high for the effective policing of the UK markets.

FSMA as originally enacted identified three types of market abuse: misuse of non-public material information, the creation of false or misleading market impressions and market distortion. The Act also provided that no behaviour of these descriptions amounted to market abuse unless contrary to the standards of a hypothetical “regular user” of the market concerned.
The Financial Services Authority (the "FSA") elaborated on the statutory provisions with what in practice has been the most important document relating to the regime: the Code of Market Conduct. The Code has a statutory basis, in that if it describes behaviour which, in the opinion of the FSA, does not amount to market abuse (under the original provisions of the Act) then that is conclusive of the matter. The Code also describes forms of conduct which, in the FSA's opinion, are likely to amount to market abuse (and this has been amended to take account of the new provisions, discussed further below). Even though the Code in this case is not conclusive, but only represents the FSA's views, market participants have tended to follow the Code as a quasi-rule book unless unusual circumstances suggest that individual guidance should be sought from the FSA in respect of a particular transaction or course of conduct.

1.3 The Market Abuse Directive

The EU's Market Abuse Directive (2003/6/EC) is one of a number of EU initiatives implementing the Financial Services Action Plan for completing the single market for financial services. The aim of the Directive is to promote clean and efficient markets, regulated in a harmonised way throughout the EU. To this end, the Directive requires member states to outlaw insider dealing and market abuse and to provide for timely disclosure of price sensitive information to market users.

The Directive resulted in the UK making changes to the existing provisions of FSMA (but not to its substantive provisions). These changes extend to new areas, such as rules governing the disclosure of price sensitive information by issuers of securities and the preparation of investment research.

The Directive is not, in most respects, a "maximum harmonisation" directive (the fact that it is not means that member states may, if they so choose, adopt their own supplementary market abuse rules). However, the Directive does lay the ground for exclusive, EU-wide rules in one area: stabilisation. This has been achieved using a Stabilisation and Share Buy-Back Regulation (2273/2003/EC) having direct effect throughout the EU.

1.4 Categories of market abuse

The result of the conflation of the new EU and old UK approaches is that there are now seven types of behaviour which can amount to market abuse under FSMA:

(i) insider dealing (in the Directive sense);

(ii) improper disclosure of inside information (Directive);

(iii) misuse of not generally available relevant information, not caught under (i) or (ii), contrary to the standards of the regular user (retained provision of FSMA);

(iv) transactions or orders to trade which create false market impressions or artificially support prices (Directive);
transactions or orders to trade which employ “fictitious devices or any other form of
deception or contrivance” (Directive); (vi) disseminating false or misleading information (Directive); and
(vii) behaviour creating false or misleading impressions or market distortion but not
captured under (iv) or (v) above and contrary to the standards of a regular user (retained
provision). In practice this category of abuse will be relevant to behaviour which does
not amount to a “transaction” in an investment (for example, misleading transactions
in an underlying commodity).

FSMA gives the FSA the power to impose unlimited civil fines on individuals and firms that
commit market abuse.

1.5 Memorandum on market abuse

The remainder of this Memorandum deals with the criminal insider dealing provisions of the
Act. A guide to the FSMA market abuse regime is available from Slaughter and May.

2. PERSONS AND DEALINGS TO WHOM THE ACT APPLIES

2.1 “Having information as an insider”

A person has information as an insider if, and only if, it is inside information and he has it from
an inside source and he knows that the information is inside information and that he has the
information from an inside source.

Inside information means information which:

> relates to particular securities or to a particular issuer of securities or to particular
issuers of securities and not to securities generally or to issuers of securities generally;

> is specific or precise;

> has not been made public; and

> if it were made public would be likely to have a significant effect on the price of any
securities (the information then being “price sensitive information” in relation to those
securities and the securities being “price-affected securities”). For this purpose, “price”
includes value.

A person can only be an insider if he both knows that information is inside information and
knows that he has the information from an inside source.
This is a high hurdle for the prosecution. “Knowledge” means more than “reasonable” belief and imports an element of certainty, if only as to the facts from which an inevitable conclusion about the information is to be obviously drawn.

See also the discussion in Section 2.4 as to what it means for the defendant to “know” that information has not been made public within the meaning of the Act and to “know” that if it were made public that it would have a significant effect on the price of securities.

2.2 “Inside source”

A person has information from an inside source if he has it through being a director, employee or shareholder of an issuer of securities or through having access to the information by virtue of his employment, office or profession; or if the direct or indirect source of his information is such a person. It is not necessary for the information to originate from the issuer of the price-affected securities. An employee of an unrelated company (for example a researcher in an investment bank) may become an insider by virtue of information, relevant to the fortunes of a particular company, which he uncovers in the course of his employment.

To commit the offence, a defendant who does not himself have the information by direct access must know that the direct or indirect source of the information was a person of the sort described who did have such direct access through his position. On this basis, it would not be sufficient for the prosecution to establish that the defendant knew, for example, that the direct or indirect source of the information was a director, employee or shareholder of a particular company if he did not also know that the inside information had come to that director, employee or shareholder through his being in that position.

2.3 “Information”

(A) Information relating to securities

Securities can be shares, debt securities (including public sector securities), rights (such as warrants) to subscribe shares or debt securities, depositary receipts and options or futures over any of the foregoing. Also included are contracts for differences referenced to any security or to a securities index.

A security must, in addition, satisfy any conditions applying to it under the Insider Dealing (Securities and Regulated Markets) Order 1994 (the “Order”). The Order (which also defines “regulated markets” – see Section 3.1) provides that for this purpose the security must be dealt in, on or under the rules of, or have its price quoted on, a regulated market. Alternatively, in the case of derivative securities such as warrants to subscribe, depositary receipts, options or futures or contracts for differences, the securities must relate to shares or debt securities which are dealt in or quoted on a regulated market.
(B) Information relating to a company

Information relates to a company not only where it is about a company but also where the information may affect the company’s business prospects. The emphasis upon information which may affect a particular company’s business prospects must cause a degree of concern to advisers who, in advising one client, learn of, or even generate, information which could be of some relevance to the business prospects of another client whom they are advising.

Information about a company’s prospects (such as may be contained in an analyst’s report) is not necessarily the same as information which may affect those prospects, although it is presumably possible to envisage some circumstances where an analyst’s report might prove to be self-fulfilling. Even if it does not have this effect, there is, of course, a risk that the information in such a report may constitute inside information to the extent that the report is not derived from information which has been made public.

(C) Specific or precise

Some may question what, if anything, is added by the use, in the alternative, of the words “specific” and “precise”. The intention is presumably to exclude from the definition information (such as market rumour or surmise) of an imprecise and general nature – the corollary of the wording, however, is that information of a precise yet general nature or of a specific yet imprecise nature will be caught. At the Committee Stage in the House of Commons, a Government minister gave as an example of imprecise, yet specific, information, the case of the company director who says to someone over lunch “our results will be much better than the market expects or knows”.

(D) Partial information

A third party may come into possession of information about a company which taken on its own is price sensitive but which when seen in the context of the company’s overall performance is perhaps not price sensitive. For example, an individual may have isolated information about a poor period of trading which may, if made public on its own, cause an immediate adverse reaction in the market. However, suppose that the management of the company is aware that the poor period has been more than offset by stronger subsequent performance. If information were released concerning the overall performance of the company the market’s reaction would be quite different from that which would occur in response to the release of partial information. Is the individual who is in possession of the partial information precluded from dealing, even though he reasonably believes that the overall condition of the company is good?

The cautious view must be that the information in possession of the insider is to be assessed on its own merits. There is no allowance in the Act for speculation as
to surrounding mitigating circumstances. However, if the insider’s belief as to the surrounding circumstances proves correct, the chances of any action being taken under the Act would seem to be remote.

2.4 “Made public”

The Act provides statutory aids to construction of the term “made public”. The relevant provisions are not, however, exhaustive as to the meaning of the term, and it is open to a court to add to, or expand, the categories.

Information is made public if it:

> is published in accordance with the rules of a regulated market for the purpose of informing investors and their professional advisers;

> is contained in records which by virtue of any enactment are open to inspection by the public;

> can be readily acquired by those likely to deal in any securities to which the information relates, or of an issuer to which the information relates; or

> is derived from information which has been made public.

If information falls into any of the above categories it is “made public” for the purposes of the Act, notwithstanding that it is in fact not known except by a select few, or even only by one person, in the case of the last category.

Information not falling within the above categories may be treated as made public even though:

> it can be acquired only by persons exercising diligence or expertise;

> it is communicated to a section of the public and not to the public at large;

> it can be acquired only by observation;

> it is communicated only by payment of a fee; or

> it is published only outside the United Kingdom.

It is to be noted that information which falls in any of the above categories may still be held not to have been made public. The provisions merely stipulate circumstances which need not stand in the way of a finding that information has been made public.
The concept of “made public” is critical to establishing the guilty intent of a defendant. The prosecution must prove that the defendant knew that the information had not been made public and that, had it been made public, it would have been likely to have had a significant effect on the price of securities. It may be difficult for the prosecution to prove that a defendant knew (rather than that the defendant had reason to believe) that information had not been made public in any of the senses indicated in the Act; it may also be difficult to prove that a defendant knew that the making public of the information in any of the indicated ways would have had a significant effect on the price of securities.

2.5 “Significant effect on price”

There is no guidance provided by the Act as to what is a “significant” effect on the price of a security. There is no absolute rule. However, a relatively small change in price is not a “significant” change. “Significant” suggests a change which would raise the eyebrows of market commentators. Compare this with the Takeover Panel’s concept of “untoward movement” in share prices (Rule 2.2 of the City Code on Takeovers and Mergers). Guidance issued by the Panel suggests that a movement of 10 per cent. or more is to be regarded as “untoward”, although an abrupt change (for example, five per cent. in a single day) may also be so regarded. It is suggested that a movement may be “significant” without being “untoward”.

An issuer of financial instruments which are admitted to trading on a UK regulated market (which includes the London Stock Exchange’s main equity market, but not the AIM) is, since 1 July 2005, under an obligation (Chapter 2.2.1 of the Disclosure Rules) to announce “inside information which directly concerns the issuer”. The definition of “inside information” for these purposes derives from the Market Abuse Directive and is slightly different from the definition in the Act. However, the Disclosure Rules do refer to inside information as being information which is likely to have a “significant effect on the price of the issuer’s financial instruments” (DR 2.2.4G(1)). The Disclosure Rules state that there is no percentage or absolute figure which can be set (DR 2.2.4G(2)) and goes on to say that an issuer is required:

“(i) to take into account that the significance of the information in question will vary widely from issuer to issuer, depending on a variety of factors such as the issuer’s size, recent developments and the market sentiment about the issuer and the sector in which it operates; and

(ii) to assume that a reasonable investor will make investment decisions relating to the relevant financial instrument to maximise his economic self interest.” (DR 2.2.5G)

This is all part of what the Disclosure Rules call the “reasonable investor test” for determining the price sensitivity of information.
3. OFFENCES

3.1 The dealing offence

A person deals in securities if he acquires or disposes of them (whether as principal or agent) or procures, directly or indirectly, an acquisition or disposal of the securities by any other person. The terms “acquire” and “dispose” include agreeing to do either of those things and entering into, or discharging, a contract creating the relevant security.

Dealing includes procuring another person to deal. The obvious example is an individual employee who causes his company to deal. Another example, which was highlighted in the debate over the use of equity derivatives in takeovers (see Section 6.6) is where an individual within a firm with inside information enters into a transaction with a customer who also has inside information, the transaction designed to benefit the customer when the inside information is made public. The individual reports the transaction through his firm’s risk management department. That department, in order to mitigate the risk apparent in the transaction, instructs dealers in another part of the firm to hedge the risk. The dealers do so by buying shares in the target company or shares which would be expected to perform in a similar fashion (for example in the same sector). It is arguable that the individual in the firm with inside information has indirectly “procured” the actual dealing in the target’s shares.

The specified circumstances in which dealings are prohibited are where:

> the acquisition or disposal in question occurs “on a regulated market”; or

> the dealing involves the services of a person acting as a “professional intermediary”; or

> where the defendant is himself acting as a professional intermediary.

As mentioned above, regulated markets are identified in the Order. Any market established under the rules of a large number of exchanges specified in the Order is a regulated market. All the major UK and European exchanges are listed as well as NASDAQ.

A professional intermediary is a person who (i) carries on business consisting either of acquiring or disposing of securities (whether as principal or agent) or of acting as an intermediary between persons dealing in securities and (ii) holds himself out to the public or any section of the public (including a section of the public constituted by persons such as himself) as willing to engage in any such business. The expression also includes employees of such persons (but only those employees engaged in the activities mentioned) but does not include persons merely because they occasionally acquire or dispose of securities (whether as principal or agent) or occasionally act as a person through whom acquisitions or disposals of securities are effected or where the activity in question is merely incidental to some other activity not falling within (i) and (ii) above.
It is unclear whether the scope of the definition of a professional intermediary is intended to encompass lawyers, accountants and others who arrange dealings on behalf of clients. The transaction may, depending on the circumstances, be said to have been effected by or on the introduction of such professionals.

3.2 The tipping offence

Under the Act, this has two possible limbs:

> encouraging another to deal, in the circumstances specified, in price-affected securities, knowing or having reasonable cause to believe that the dealing would take place in the specified circumstances; and

> passing on inside information otherwise than in the proper performance of the functions of the individual’s employment, office or profession.

In both cases, for there to be an offence, the defendant must know that the information he is passing on, or the information on which he is basing his encouragement, is inside information in the sense defined by the Act.

A transaction in a derivative entered into with mutual inside information, which is subsequently automatically hedged in price-affected shares, may constitute an “encouraging” offence. See Sections 3.1 and 6.6.

The formulation does not address situations where someone is recommended to refrain from buying or selling if, in the light of inside information held by the person giving the recommendation, it would be disadvantageous to do so. A recommendation not to deal is apparently not caught, because the “encouraging” limb of the offence requires an expectation that a dealing would take place. In relation to the “disclosure” limb of the offence, such activity might be caught, because the offence simply involves the improper disclosure of inside information. A separate defence is, however, available if the defendant can show that he did not expect any person, because of the disclosure, to deal in securities in the specified circumstances. Presumably it was decided that it would be too difficult to establish a conviction based upon the allegation that someone refrained from dealing in securities following receipt of a tip from an insider, whether that tip involves a simple recommendation or the disclosure of the inside information itself.

4. DEFENCES

4.1 General defences

It is a defence to a charge of either dealing or encouraging another to deal for the defendant to show that:

> he did not at the time expect the dealing to result in a profit attributable to the fact that the information in question was price sensitive information in relation to the securities;
at the time he believed on reasonable grounds that the information had been disclosed widely enough to ensure that none of those taking part in the dealing would be prejudiced by not having the information; or

he would have done what he did even if he had not had the information.

It is a defence to an allegation of disclosing inside information for the defendant to show that he did not expect:

any person, because of the disclosure, to deal in securities; or

the dealing to result in a profit attributable to the fact that the information was price sensitive information in relation to the securities.

“Profit” includes “avoidance of a loss”.

The first three of these general defences deserve further comment.

(A) “Lack of expectation of securing a profit or avoiding a loss”

The defence is only available to those who do not foresee the inside information having any impact on the results of the dealing. Others whose defence is that they did not intend to exploit inside information must rely on the defence which exempts an individual from doing what he would have done even if he had not had inside information (see below).

The onus is on the defendant to show that he is within the defence.

This defence is only available to a person accused of dealing or encouraging another to deal, not where he is accused of disclosing information.

(B) “No prejudice defence”

This allows a defence based on disclosure. It also covers the position where an individual is acting as agent for or representing another person and the information is not disclosed to that other person although he or it is a party to the transaction. It allows the dealing to be innocent if disclosure is made to the agent or representative and the principal is not prejudiced by not having the information.

If the disclosure leads to other parties subsequently using the information to make a profit or avoid a loss, then the first party may still be guilty under the “disclosing” limb of the tipping offence, as the defence does not apply to the latter offence. To illustrate by an example: if A discloses inside information to B in order not to take advantage of the inside information in his dealing with B, he must nevertheless not expect B subsequently to use the information to his (B’s) own advantage. The dealing between
A and B must be isolated until the information is no longer unpublished or no longer price sensitive.

Further, the improper disclosure of inside information, in an attempt to avail oneself of the “no prejudice” defence, could itself be an offence under the “disclosure” limb of the tipping offence.

(C) “Would have done it anyway”

This defence allows for dealing under some sort of compulsion (such as financial difficulties) and may also allow dealings pursuant to a regular programme (such as an employee share scheme). It is more difficult to determine whether the defence would apply where a person has a settled intention to deal before he becomes an insider and completes the dealing thereafter. As the onus is on the defendant to show that he is within the defence, a person in this position would have to have strong objective evidence of his settled intention, including, for example, evidence as to the number of securities which he originally determined to buy or sell.

4.2 Market makers

A market maker can escape liability for the dealing offence or the encouraging limb of the tipping offence if he can show that he dealt in the securities in question in good faith in the course of his business as a market maker or his employment in the business of a market maker. It is not necessary that any information he had in relation to the dealing was information acquired in the normal course of his business or employment.

Because of the introduction by the London Stock Exchange of SETS (an electronic order book) there are no longer market makers in FTSE 100 and UK FTSE Eurotop 300 stocks. A trader in these stocks must rely on the general defences or the “market information” defences discussed next.

4.3 “Market information”

(A) Reasonableness

A person charged with the dealing offence or the encouraging limb of the tipping offence can escape liability by showing that the only information he had as an insider was market information and that it was reasonable for a person in his position to deal in the securities despite having that information at the time of the dealing. Market information is information about one or more of the following:

> the fact that securities of a particular kind have been or are to be acquired or disposed of or that their acquisition or disposal is under negotiation or consideration;
the fact that securities of a particular kind have not been or are not to be acquired or disposed of;

the number of securities being acquired or disposed of or whose acquisition or disposal is under negotiation or consideration;

the price or price range at which those securities are to be acquired or disposed of under any of the above transactions;

the identity of the persons involved or likely to be involved (in any capacity) in the acquisition or disposal.

In determining whether or not it was reasonable for the defendant to have dealt in these circumstances, the content of the relevant information, the circumstances in which he first had the information and in what capacity and the capacity in which he dealt must all be taken into account. When applying the reasonableness test in using market information in specific circumstances, reference should be made to the rules and principles of the Model Codes and the regulatory requirements of the FSA.

Some concern has been expressed about the requirement for it to have been reasonable for the person having the relevant market information at the time of the dealing to have dealt or to have encouraged the dealing in the securities. The Law Society has pointed out that it is unsatisfactory for the commission of a serious criminal offence to depend upon a judgment as to whether it was “reasonable” for a person to deal in these circumstances.

(B) Transaction facilitation

If the only inside information which an individual has is market information arising directly out of his involvement in an acquisition or disposal or series of acquisitions or disposals of securities, then he is not guilty of either the dealing offence or the encouraging limb of the tipping offence if he can also show that he acted in connection with the acquisition or disposal or series of such and to “facilitating” the accomplishment of the acquisition or disposal or series of such.

This defence does not require a “reasonableness” test and should allow a potential offeror or stake-builder to operate without inhibition by reason only of the information he holds as to his own intentions.

The Securities and Investments Board (“SIB”) (predecessor of the FSA) suggested in Guidance Release 1996/4 that “facilitating” should be construed relatively narrowly. It should not be regarded as extending to derivatives transactions designed only to provide an economic hedge against the costs of an acquisition. See Section 6.6 for a fuller discussion.
4.4 Price stabilisation

It is a complete answer to the dealing or encouraging offences for the individual to show that he acted in conformity with the stabilisation rules made by the FSA under Section 144 of FSMA or, following implementation of the Market Abuse Directive, the directly-effective Commission’s Buy-Back and Stabilisation Regulation. This means that the stabilisation activities of a manager or underwriter of an offer of securities need not be disrupted because a relevant individual comes into possession of price sensitive information. As stabilisation is an activity with a clear objective in view, to support the existing offer price, the stabilisation defence may be seen as a concrete sub-category of the “would have done it anyway” defence.

It would be unwise for the stabilisation manager to change its strategy as a result of obtaining inside information. It will be necessary to show that all dealing was strictly for the purposes laid down in the rules – any profitable or loss-avoiding position which extends further than what is necessary to achieve the purposes specified in the rules may fall outside the protection of the defence.

As a practical matter, the stabilisation manager might be well advised to conduct the stabilising activities on the other side of a Chinese wall to those advising the offeror on corporate finance matters, who are most likely to obtain price sensitive information relating to the offeror. The price sensitive information held by the dealers engaged in stabilisation activities is in most cases likely to be “market information”, so that the dealers may additionally rely on the market information defences as well as the stabilisation defence.

The defence does not apply to passing on inside information. This is not particularly remarkable since the price stabilisation rules made under Section 144 and the Regulation are primarily focused upon dealings in shares, not in passing on inside information.

5. PENALTIES AND TERRITORIAL SCOPE

5.1 Enforcement and penalties

Responsibility for investigating and instituting proceedings against a person or firm for insider dealing lies with the FSA, the Secretary of State for Trade and Industry or, in certain circumstances, the Serious Fraud Office. These bodies have agreed guidelines to decide which of them should investigate and prosecute cases of insider dealing.

Because there is a potential overlap between the criminal offences of insider dealing, market manipulation and the civil prohibition on market abuse, the FSA has issued guidelines to assist it in determining the appropriate course of action when a person or firm has fallen foul of more than one of these regimes.
A person convicted of insider dealing is liable, on summary conviction, to a fine or imprisonment for a term not exceeding six months or to both or, on conviction on indictment, to a fine or imprisonment for a term not exceeding seven years, or to both.

5.2 Territorial scope

The dealing offence can only be committed:

> by a person within the United Kingdom at the time when he is alleged to have done any act constituting or forming part of the alleged dealing; or

> if the regulated market on which the dealing is alleged to have occurred is declared by the Treasury to be a market which is to be treated as regulated in the United Kingdom; or

> if the relevant professional intermediary was within the United Kingdom at the time when he is alleged to have done anything by means of which the offence is alleged to have been committed.

The tipping offence can only be committed:

> by someone within the United Kingdom at the time he is alleged to have disclosed the information or encouraged the dealing; or

> if the recipient of the information or encouragement was within the United Kingdom at the time of receipt.

6. TRANSACTION DANGERS

6.1 Sector information

Since inside information can relate to a group of particular issuers of securities under the provisions of the Act, information about the business sector in which a company operates is capable of falling within the definition of inside information. The extension of inside information in this way may have some disadvantageous consequences. First, the acquisition strategy of a particular company may be frustrated by these provisions because the extent of the information which the directors of the company have about the sectors in which it operates and in which it intends to make acquisitions goes far beyond information which has been “made public”. Secondly, financial and other advisers will, in the course of advising their corporate clients, inevitably generate or obtain information about the sector or sectors in which such clients operate. Such advisers may, through advising in the light of such information, risk exposure under the Act to the extent that the information has not been made public or been derived from other information which has been made public. The exposure would, in such circumstances, arise if such information would be likely to have a significant effect on the price of any securities, were the information to be made public.
6.2 Underwriting: information not in the prospectus

A secondary offering of securities which are already listed or dealt in on a regulated market is an offering of securities within the Act. New securities are usually not within the Act at the time of underwriting, because they will not then usually be dealt in on a regulated market. However, much depends on the regulated market in question and whether dealings in yet-to-be-issued securities are dealings “on” market. In the case of the London Stock Exchange, underwriting and placing of new securities prior to listing are not dealings on the market (but certain other “subject to listing dealings” are on market).

It is quite possible that the underwriter (or at least the lead underwriter) will have inside information other than just “market information”. It is often the case that confidential disclosure will have been made of profit projections, management plans and proposed acquisitions, all of which is too vague or unverifiable to be able to be included in listing particulars, a circular or a prospectus. This information could possibly constitute inside information, although if it meets the “specific or precise” and “significant effect on price” tests (see Sections 2.1 and 2.5), it should normally be within the category of information to be disclosed in the offering document.

6.3 Bought deals

The position is similar to that applicable to underwritings, including the possibility that the buyer will have inside information over and above “market information”.

The buyer would probably seek to show that the terms of the bought deal were such that he had had no expectation of a profit attributable to the inside information or that he would have engaged in it even if he had not had the price sensitive information.

6.4 Placings

Similar considerations apply as for bought deals. However, it is unlikely that the placee will have had the same detailed discussions with the issuer as the placing agent or that the placing agent will disclose price sensitive information which is not in the placing memorandum.

6.5 Disposals of rumps

The existence or size of a rump could well constitute price sensitive information; however, it is also “market information”. It should be relatively straightforward for an underwriter to rely on the market information defence when disposing of securities comprised in the rump of an issue or offer, without disclosing the existence or size of the rump.
6.6 Takeovers

A bank acting in connection with a takeover is a professional intermediary, and thus all dealings with or through the bank are within the Act.

Persons who have inside knowledge concerning the bidder or the target and who are shareholders in the target might have some difficulty if the offer document or listing particulars do not contain all price sensitive information. Once more, the “no expectation of profit” (because the offer price reflects the information) and “would have done it anyway” defences will be relied on heavily.

Certain strategies had been developed in the context of takeovers to allow potential bidders to obtain an economic benefit from the favourable effect which the announcement of their bid would have on target share prices, by entering into derivative contracts on those shares which pay out if the price increases. The arguments for saying that no offence under the Act would be committed may be summarised as follows:

> If the bidder enters into derivatives contracts with counterparties who do not know about the bid the bidder can rely on the “transaction facilitation” limb of the market information defence, because the purpose of a derivatives contract is to offset the cost of the bid, by ensuring that some of the uplift in the target’s share price accrues, via the contracts, to the bidder.

> If the bidder enters into derivatives contracts with its own financial adviser, the “equality of information” defence applies. In this case, the financial adviser is exposed to a certain loss if the bid proceeds; however, most banks would have a central risk management department which would ensure that the exposure under the derivatives contract would be hedged in the normal course of business. Such hedging (in the mutual target shares or shares of business in the same sector) would be carried out without knowledge of the bid by another part of the bank and therefore no individual would be in breach of the Act.

Critics of the equity derivatives strategy argued that, in the first case, too wide a meaning was being given to the term “facilitating the accomplishment of the acquisition...”. A transaction, such as a derivative, which would reap a purely economic benefit, could not be said to “facilitate” the acquisition of the target’s share capital. In the second case, it was argued that the individuals who caused the bank to enter into the equity derivative, and who reported it to central risk management, either “procured” or “encouraged” the subsequent dealing by those hedging the derivative and that therefore the former individuals, who knew about the impending bid, may have been guilty of either the dealing or the tipping offence.

In December 1996, the SIB issued formal guidance (Guidance Release 1996/4) in which it indicated its support for the views which doubted the legality of the equity derivative strategies. In any case, following the introduction of FSMA such strategies are likely to
amount to market abuse in that they distort the market. This is discussed in the guide to the FSMA market abuse regime available from Slaughter and May.

6.7 Own share purchases

Since 1 July 2005, companies buying back their own shares can benefit from the safe harbour provided by the Buy-Back and Stabilisation Regulation issued by the European Commission. Compliance with the Regulation is a defence under both the Act and FSMA’s market abuse regime.

In order to benefit from the safe harbour, a buy-back programme must comply with the terms of the Regulation and:

“the sole purpose of that buy-back programme must be to reduce the capital of an issuer (in value or in number of shares) or to meet obligations arising from any of the following:

(a) debt financial instruments exchangeable into equity instruments;

(b) employee share option programmes or other allocations of shares to employees of the issuer or of an associate company.”

In any other case, those within the company who take or implement the decision to purchase the company’s own shares are at risk of committing an offence if they have inside information (other than information about the proposal itself).

If those involved in the decision only have the “market information” that the purchase of shares is to take place or is under consideration, they will be able to rely on the market information defence, without having to show reasonableness.

6.8 Debt to equity exchanges

It is likely that agreements to acquire securities would be entered into at a time when the securities would not be within the Act. In any event, dealings between the company and the bankers would be subject to the limited disclosure defence. The bankers may, however, be prohibited from on-selling the equity while they remain in possession of inside information resulting from their negotiations with the company.

6.9 Stake building and hedging

The market information defence (without the reasonableness test) will apply, if the only inside information held by those procuring the building of a stake relates to the transaction involving, in whole or in part, the acquisition of the stake.

See the discussion at Section 6.6 on the use of equity derivatives in this context.
The possession of inside information might prevent the closing-out of an option or some other form of derivative such as a swap. The discharge of the contract creating the option, swap, etc. is a disposal, so an early close-out transaction would be caught.

6.10 Repos and stock-lending

The true legal analysis of a usual repo (or usual stock lending transaction) is of a sale of particular securities with an agreement to repurchase equivalent securities. Thus, such transactions would potentially be caught by the insider dealing provisions, even though most dealers in the repo market would view repos as short-term financing operations.

In practice, this may not be of great significance to a company in initially agreeing a repo, so long as the company’s own securities are not the subject matter of the repo, but it would become significant to any desire to close-out (e.g. by reason of default or margin requirements) if in the meantime the company, or its counterparty, had become privy to inside information concerning the company whose securities are the subject of the repo, such as an unannounced takeover proposal. The company would seek to rely on the “would have done it anyway” defence.

This memorandum is not intended to contain definitive legal advice, which should be sought as appropriate in relation to any particular transaction. If further information or advice is required, please contact your usual adviser at Slaughter and May.

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