MARKET ABUSE – company to be listed on the Alternative Investment Market – take up of shares in the placing slow – the idea emerged that if a spread bet were placed then the spread betting firm would hedge the bet through a contract for differences with a counterparty who would then hedge the contract for differences by purchasing shares in the placing thus completing the placing – whether either or both of the Applicants engaged in market abuse – no – whether penalties should have been imposed – no – whether the amounts of the penalties were appropriate - no – whether Mr Tatham was in breach of Principles 2 and 3 – no – references determined in favour of the Applicants – FSMA 2000 Ss 64, 66, 118 and 123

FINANCIAL SERVICES AND MARKETS TRIBUNAL

PAUL DAVIDSON

First Applicant

ASHLEY TATHAM

Second Applicant

- and -

THE FINANCIAL SERVICES AUTHORITY

Respondent

Sitting in London on 18-20, 23-27 and 30-31 January 2006;
1, 13-16, 21, 22, 24, 27 and 28 February 2006; and
2, 6 and 7 March 2006

Tribunal: DR A N BRICE (Chairman)
MR C A CHAPMAN
MR J PARSLOE

The First Applicant in person

Dr Michael von Pommern-Peglow and Sir Nicholas Bonsor Bt for the Second Applicant

Tom Beazley QC, with Javan Herberg of Counsel, instructed by the Financial Services Authority for the Respondent

CONTENTS

DECISION

Background

1. Mr Paul Davidson (Mr Davidson) was the majority shareholder in, but not, at the relevant time, a director of, a company called Cyprotex PLC (Cyprotex), the ordinary share capital of which was to be admitted to trading on the Alternative Investment Market (AIM) of the London Stock Exchange. Mr Nigel Howe (Mr Howe) was an employee of the nominated broker in charge of the placing, namely, Messrs Gilbert Elliott (Gilbert Elliott). The take up of shares in the placing was slow and the idea emerged that, if a spread bet were placed in respect of shares in Cyprotex, then the spread betting firm would hedge the bet through a contract for differences with a counterparty, who would then hedge the contract for differences by purchasing shares in the placing, thus completing the placing.

2. The flotation was due on 15 February 2002. A few days before that date, and on the account of Mr Davidson, Mr Howe placed a large spread bet with a firm called City Index Limited (City Index) of which Mr Ashley Tatham (Mr Tatham) was the executive director of trading. City Index hedged the bet by a contract for differences, the counterparty of which was Dresdner Kleinwort Wasserstein Securities Limited (Dresdner Securities). Dresdner Securities hedged its exposure by purchasing shares in Cyprotex in the placing. By this means the placing was filled.

The references

3. On 23 October 2003 the Financial Services Authority (the Authority) issued a Decision Notice to Mr Davidson, Mr Howe and Mr Tatham. The Decision Notice stated that the Authority had decided to impose a penalty of £750,000 on Mr Davidson; a penalty of £300,000 reduced to £50,000 on Mr Howe; and a penalty of £100,000 on Mr Tatham. The penalties were imposed because the Authority was of the view that Mr Davidson, Mr Howe and Mr Tatham had agreed to a scheme or arrangement to facilitate the flotation of Cyprotex. The scheme or arrangement was that a spread bet would be placed with City Index who would hedge its position by a contract for differences so that the counterparty to the contract for differences would hedge its own exposure by purchasing shares in the placing, thus ensuring that the placing was filled. The Authority was also of the view that all three persons were aware (or agreed) that these arrangements would not be disclosed. It followed, in the view of the Authority, that the arrangements gave a false and misleading impression as to the demand for, or the value of, the shares in Cyprotex and so amounted to market abuse within the meaning of section 118 of the Financial Services and Markets Act 2000 (the 2000 Act) from which it followed that the Authority had power, under section 123 of the 2000 Act, to impose the penalties.

4. Mr Davidson was not an approved person under the 2000 Act but Mr Howe and Mr Tatham were. The Decision Notice also stated that the Authority considered that Mr Howe had failed to comply with Principles 1 (integrity), 2 (due skill, care and diligence) and 3 (failure to observe proper standards of market conduct) and that Mr Tatham had failed to comply with Principles 2 and 3. No separate penalties were imposed on Mr Howe and Mr Tatham in respect of their breaches of the Principles as

the Authority considered that such breaches were covered by the penalties for market abuse.

5. Mr Davidson and Mr Tatham referred the Decision Notice to the Tribunal. Mr Howe did not.

The legislation

6. Section 123 of the 2000 Act contains the provisions giving the Authority power to impose penalties in cases of market abuse and provides:

> **"123(1) If the Authority is satisfied that a person ("A") -**
>
> **(a) is or has engaged in market abuse, or**
>
> **(b) by taking or refraining from taking any action has required or encouraged another person or persons to engage in behaviour which, if engaged in by A, would amount to market abuse**
>
> **it may impose on him a penalty of such amount as it considers appropriate.**
>
> **(2) But the Authority may not impose a penalty on a person if, having considered any representations made to it in response to a warning notice, there are reasonable grounds for it to be satisfied that –**
>
> **(a) he believed, on reasonable grounds, that his behaviour did not fall within paragraph (a) or (b) of subsection (1), or**
>
> **(b) he took all reasonable precautions and exercised all due diligence to avoid behaving in a way which fell within paragraph (a) or (b) of that subsection.**
>
> **(3) If the Authority is entitled to impose a penalty on a person under this section it may, instead of imposing a penalty on him, publish a statement to the effect that he has engaged in market abuse."**

7. Market abuse is defined in section 118 of the 2000 Act and, at the relevant time, the relevant parts of section 118 provided:

> **"118(1) For the purposes of this Act, market abuse is behaviour (whether by one person alone or by two or more persons jointly or in concert) -**
>
> **(a) which occurs in relation to qualifying investments traded on a market to which this section applies;**
>
> **(b) which satisfies any one or more of the conditions set out in subsection (2); and**
>
> **(c) which is likely to be regarded by a regular user of that market who is aware of the behaviour as a failure on the part of the person or persons concerned to observe the standard of behaviour reasonably expected of a person in his or their position in relation to the market.**
>
> **(2) The conditions are that - …**
>
> **(b) the behaviour is likely to give a regular user of the market a false or misleading impression as to the supply of, or demand for, or as to the price or value of, investments of the kind in question. …".**

8. Section 64 of the 2000 Act provides that the Authority may issue statements of principle with respect to the conduct expected of approved persons. Under that provision the Authority has issued "Statements of Principle and Code of Practice for Approved Persons" (APER). APER 4.2 states Principle 2 which is that an approved person must act with due skill, care and diligence in carrying out his controlled function. APER 4.3 states Principle 3 which is that an approved person must observe proper standards of market conduct in carrying out his controlled function. Section 66

provides that the Authority may take action against a person if it appears to the Authority that he is guilty of misconduct which includes a failure to comply with a statement of principle issued under section 64.

The issues

9. We identified the following issues for determination in the references:

(1) whether the Applicants engaged in market abuse within the meaning of section 123(1) and section 118; if so

(2) whether penalties should have been imposed under section 123; if so

(3) whether the amounts of the penalties were appropriate; and

(4) whether Mr Tatham was in breach of Principles 2 and 3.

The evidence

10 Twenty bundles of documents were produced by the parties. The bundles contained, among other things, transcripts of tapes of telephone conversations. Also put in evidence were compact discs prepared from the tapes. We listened to some of the telephone conversations during the course of the hearing.

11 Oral evidence was given by Mr Davidson on his own behalf and oral evidence on behalf of Mr Davidson was also given by **Mr Robert Long** who was the lead director at Cyprotex in charge of the placing. Oral evidence was given by Mr Tatham on his own behalf.

12. Oral evidence was given on behalf of the Authority by:

Mr Phil Adams of the Manchester Office of Altium Capital Limited (Altium). Altium was the nominated adviser (Nomad) to Cyprotex when it was floated on AIM and Mr Adams was the head of the transaction team;

Mr Jonathan Cooke, who, at the relevant time, was a Managing Director of the Equity Division of Dresdner Kleinwort Wasserstein Limited;

Mr Mark Egerton who was appointed as a non-executive director of Cyprotex on 4 December 2001 and Chief Executive Officer on 1 May 2003 from which post he resigned on or about 1 September 2003;

Mr Philip Goodstone, Solicitor, of Messrs Addleshaw Goddard (previously Messrs Addleshaw Booth & Co) Solicitors of Manchester (Addleshaws);

Mr Paul Henderson, the Director of Global Equities Compliance at Dresdner Securities;

Ms Janet Holmes who, at the relevant time, was employed by the Authority as an associate in the market conduct and surveillance team;

Mr Nigel Kennedy Howe who, at the relevant time, was an employee of the firm of Gilbert Elliott who were the nominated brokers for the Cyprotex flotation;

Mr Stephen Christian Judge, who, at the relevant time, was the compliance manager at City Index;

Mr Julian Knight who, at the relevant time, was the Managing Director of Gilbert Elliott;

Mr David Leahy who was appointed as a director and the chief scientific officer of Cyprotex on 4 December 2001;

Mr Darren Lennard who is now the Managing Director of Dresdner Securities but who, at the relevant time, was Vice-President;

Mr Simon Mansell who, at the relevant time, was the Chief Operating Officer of City Index and who had an oversight of compliance functions;

Mr John Nicholson who, at the relevant time, was a director of Cyprotex; Mr Nicholson's background was in management in the chemical industry and he joined Cyprotex in October 2001 and was appointed Managing Director in December 2001;

Mr David Nowell, who at the relevant time was employed by the Authority in its transaction monitoring unit;

Ms Rachel Prys-Picard, Solicitor, who at the relevant time was employed by Addleshaws;

Mr Mark Simon Schreiber, Solicitor, who at the relevant time was General Counsel for City Index with a senior compliance role;

Mr Matthew Starbuck who, at the relevant time, was a trader with Dresdner Securities on the contract for differences desk; and

Mr Mark Ticehurst who at the relevant time was the Head of Client Management at City Index with responsibility for vetting and setting up clients' accounts and setting and collecting margin requirements.

13. Witness statements containing evidence on behalf of the Authority had been served by:

Sir Anthony Jolliffe, who, at the relevant time, was the Chairman of Jolliffe International and a director of Credo Corporate Finance which was part of Credo Group (UK) Limited;

Mr Larry Maddy who, at the relevant time, was an institutional equity salesman with Gilbert Elliott; and

Mr Jacques Tredoux, who, at the relevant time was the Chief Executive Officer of Credo Group (UK) Limited.

14. As the Applicants indicated that they did not wish to question these witnesses their statements were admitted as evidence.

15. Expert evidence was given on behalf of the Authority by:

Mr William Donald Brown FCA, a partner in a fund management organisation. Mr Brown is the Chairman of the AIM Advisory Group of the London Stock Exchange.

Mr Jonathan Hinton FICA of Deloitte & Touche LLP. Mr Hinton has led numerous public company transactions including the bringing of companies to AIM and the Official List. He has also acted as nominated adviser and sponsor to companies quoted on AIM and the Official List. Mr Hinton had prepared two reports, one dated 7 May 2004 for Mr Davidson's reference and one dated 31 December 2005 for Mr Tatham's reference.

The facts

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

Mr Davidson

17. Mr Davidson started his career as a pipe-fitter and welder and invented a pipe-fitting joint called the Oystertec converter. For the ten years prior to 2001 Mr Davidson was a self-employed product designer and developed a number of commercially successful inventions. In 1999 he and others incorporated a company called Oystertec Plc (Oystertec) to develop and market the converter. Mr Davidson was a director of Oystertec from October 1999 and Oystertec was admitted to AIM in February 2001. At that time Mr Davidson was the largest shareholder in Oystertec, holding 29.6% of the shares before the placement and 22.7% thereafter. At a placing price of 23 pence his shareholding was then worth approximately £6.8 million. By 2001 his fortune was measured in tens of millions.

18. In August 2001 Mr Davidson was concerned with a private placing of shares in a hearing-aid company called Sense-Sonic of which he was not a director but was a consultant and the largest shareholder. It was hoped to float Sense-Sonic on AIM in October or November 2001 but this was postponed when the decision to float Cyprotex was taken in November 2001.

19. Mr Davidson was also involved with another company called Galileo Innovation plc (Galileo) (formerly called Facilities Corporate Management) and was a consultant to, but not a director of, that company. Galileo acted as a business accelerator company to provide management expertise, structure and financing to enable United Kingdom inventions to be marketed. Mr Robert Long (Mr Long), who later became a director of Cyprotex, was employed by Galileo.

20. From the evidence before us it is clear that Mr Davidson had experience as a director of a number of companies.

Cyprotex

21. In June 2001 the company later called Cyprotex acquired the assets and goodwill of a business relating to screening for the discovery of medicines. Mrs Davidson knew the wife of one of the directors and wished to help the company financially so Mr Davidson provided finance by way of guarantee. He later became the majority shareholder, holding about 76% of the shares. He became a director on 21 April 2001 but resigned as a director in November 2001.

22. In or about November 2001 the board of Cyprotex formally decided to float Cyprotex on AIM in order to raise money to make capital investments. Mr Davidson was not a director at the time the decision was made. Nevertheless we accept the evidence of Mr Long that, as Mr Davidson was the largest shareholder, no action in relation to Cyprotex on matters of importance would be taken without his consent. Mr Davidson accepted that he wanted to float Cyprotex because he "would get £10 million". He also accepted that, as the largest shareholder, he could have blocked the float.

23. On 4 December 2001 Mr Long was appointed a director of Cyprotex with a view to promoting and managing the flotation. He was the director who managed the procedural aspects of the flotation and he was the director who was in contact with the nominated adviser. Mr Long remained employed by Galileo to whom Cyprotex paid

£250,000 for his services. Mr John Nicholson (Mr Nicholson) and Mr David Leahy (Mr Leahy), were also directors of Cyprotex and were part of the Cyprotex management team involved with the flotation.

24. When the decision to float had been taken Mr Davidson took steps to reduce the number of shares which he held. He made gifts of some of his shares to various charitable entities and other individuals. He gave shares to Manchester University to assist in the financing of an engineering department and he also gave shares to a school in Bolton to assist in the building of a technology centre. The result was that prior to the placing he held 46.69% of the shares rather than about 76%. Mr Davidson was not sent a copy of the prospectus until its final publication on 12 February 2002 and took no formal part in the placing. He did not attend any presentations during November or December 2001.

25. On 4 January 2002 resolutions were passed by the board of Cyprotex so that each of the authorised ordinary shares of £1 were subdivided into 1,000 shares of 0.1 pence each and the authorised share capital was increased from £1,000 to £160,000 by the creation of 159,000,000 new ordinary shares of 0.1 pence each. Thus at that time 160,000,000 shares of 0.1 pence each were authorised (£160,000) and 68,000,000 (£68,000) were issued and fully paid.

Mr Tatham

26. Mr Tatham joined City Index in January 1999. He was responsible for setting up the equity derivatives desk and, at the relevant time, he was an executive director of City Index and head of trading. He ran the equity derivatives desk, which had about eleven people, and his main responsibility was risk management in relation to that desk. Mr Tatham was an approved person under the 2000 Act and City Index was an authorised person. Mr Tatham had known Mr Howe since about 1999 and was Mr Howe's contact at City Index for equity trading. He also met Mr Howe about once a year at corporate functions organised for clients of City Index.

Mr Howe

27. In May 2001 Mr Davidson met Mr Howe. The board of Oystertec (including Mr Davidson) were giving a presentation to a number of brokers and institutions to raise money in order to purchase a division of another company and Mr Howe was there. Mr Howe was an approved person under the 2000 Act and was with the stockbroking firm of Gilbert Elliott. Mr Howe also met Mr Long, a director of Cyprotex, at the same presentation. Mr Howe and Mr Davidson became friends and met again socially thereafter. Some of these meetings were at The City Tup, a public house near the offices of Mr Howe. The first time that the firm of Gilbert Elliott was instructed by one of the companies in which Mr Davidson had an interest was in August 2001 when the private placing of Sense-Sonic took place.

28. Mr Howe had been spread betting since 1985 and had operated a spread betting account with City Index for seventeen years; by 2001 he was an experienced spread better. Mr Howe started by spread betting on sports and index trading but, in the late 1990s, started single stock trading, that is, placing spread bets on individual share prices. It was in that connection that he became acquainted with Mr Tatham.

29. Shortly after his first meeting with Mr Davidson, Mr Howe experienced financial difficulties. His account with City Index was overdrawn by about £22,700 and his ability to trade with City Index was suspended. He also had an overdraft at his bank and other debts. Mr Howe told Mr Davidson about his financial difficulties, and that his house was about to be repossessed, and on 28 June 2001 Mr Davidson very generously transferred the sum of £50,000 to Mr Howe. At some time thereafter, when Mr Howe's ability to trade with City Index was still suspended, Mr Howe and Mr Davidson discussed the subject of spread betting and Mr Howe explained that it was tax-efficient as no stamp duty, income tax or capital gains tax was payable. Mr Howe also explained that it was possible to bet that the price of shares would go down as well as up and that when a bet was placed it was necessary only to deposit a percentage of the potential loss. As explained below, we accept the evidence of Mr Davidson that Mr Howe suggested that, if Mr Davidson were to open a spread betting account, and were to give Mr Howe authority to trade on it, Mr Howe might be able to make sufficient gains to repay Mr Davidson the £50,000 which had been transferred.

Mr Davidson opens an account with City Index

30. On or about 31 August 2001 Mr Howe met Mr Mark Ticehurst (Mr Ticehurst), the Head of Client Management at City Index. Mr Howe told Mr Ticehurst that he would like him to meet a friend who would like to open a spread betting account with City Index. In September 2001 Mr Howe visited Mr Davidson on his boat in Palma, Majorca. During that visit they both discussed the Clubhaus transaction (which is described below) and also the principles of spread betting. It was arranged that Mr Ticehurst and Mr Tatham should fly out and join Mr Davidson and Mr Howe on the boat.

31. Accordingly, on 4 September 2001, Mr Ticehurst and Mr Tatham flew to Palma to meet Mr Davidson. Mr Davidson was given a copy of the City Index brochure pack (including its terms and conditions which gave a risk warning that City Index maintained its financial stability by hedging its risk against large bets) and was urged to read them. However, we accept the evidence of Mr Davidson that he only glanced at the terms and conditions at that time and asked that they be sent to his solicitor, Mr Mark Warburton (Mr Warburton) of Addleshaws. Mr Davidson later received an email to say that that had been done. However, Mr Warburton later told Mr Davidson that he had not, in fact, read the terms and conditions.

32. Also on 4 September 2001 the formal documents were signed to enable Mr Davidson to open an account with City Index. Mr Davidson stated on the application form that the approximate value of his assets was £25 million. Mr Davidson was informed that City Index were obliged to report every trade to the Authority. We accept the evidence of Mr Ticehurst that Mr Davidson did not appear to have a sophisticated knowledge of spread betting and was getting advice from Mr Howe. Mr Tatham and Mr Ticehurst returned home on 5 September 2001. Mr Howe earned an introduction fee of £8,000 from City Index for introducing Mr Davidson.

33. We accept the evidence of Mr Tatham that there were no specific discussions at this meeting relating to hedging, or to City Index's approach to hedging, and that his impression was that Mr Davidson was not the type of person who would be interested in the more technical side of financial transactions. However, Mr Davidson

did mention to Mr Tatham that he might want to convert his holding of shares in Oystertec into a spread bet, the gains on which would be tax-free; Mr Tatham told Mr Davidson in general terms that, if he converted his holding of shares to a spread bet, he would no longer be the legal owner of the shares.

Mr Davidson gives Mr Howe authority to trade

34. On 18 September 2001, after he had returned from Majorca, Mr Davidson arranged for the transfer of £250,000 to City Index to open his account and on 20 September 2001 he signed a letter of authority giving Mr Howe authority to trade on his (Mr Davidson's) account with City Index. The letter stated:

> "I have taken independent legal advice in relation to this letter and am fully aware of City Index's terms and conditions."

35. Under the authority to trade Mr Howe had total discretion to trade on Mr Davidson's account with City Index and there was no provision that Mr Davidson had to be informed. Mr Davidson remained solely responsible for his account and for monitoring the positions on it. Mr Howe placed bets on behalf of Mr Davidson relating to stocks chosen by Mr Howe and not by Mr Davidson. Mr Davidson never placed a spread bet himself with City Index – all the bets were placed by Mr Howe. Mr Howe would telephone Mr Davidson before placing large bets and would speak to him regularly about the progress of the bets which had been placed. If Mr Davidson were not available then Mr Howe would leave a message with his (Mr Davidson's) secretary. Initially the bets placed by Mr Howe for Mr Davidson concerned equities which were unrelated to any of Mr Davidson's companies.

36. In the weeks after the account had been opened Mr Howe, on behalf of Mr Davidson, placed ten spread bets; there were losses in respect of three and gains in respect of seven. The net gain on the account between September 2001 and 31 January 2002 was £625,363.75. We accept the evidence of Mr Tatham that Mr Davidson never talked to him about the details of any bet but did discuss the transfer of money.

37. There was a dispute at the hearing about the reason why Mr Davidson opened an account with City Index. Mr Davidson said that it was to assist Mr Howe to make money from bets so that Mr Howe could repay the £50,000 which Mr Davidson paid to Mr Howe on 28 June 2001. The Authority suggested that it was to enable Mr Davidson to take the tax benefits of rolling over some of his shareholdings into spread bets. We are of the view that there may have been a number of reasons for the opening of the account but that at least one of them was to assist Mr Howe. That is consistent with the evidence of Mr Ticehurst (that Mr Davidson did not have a sophisticated knowledge of spread betting and received advice from Mr Howe), it explains the authority to trade, and it is consistent with the subsequent payments made by Mr Davidson to Mr Howe. It is also consistent with the fact that Mr Davidson did not himself place any spread bets. We accept the evidence of Mr Davidson that he had agreed that Mr Howe would receive a percentage of any gains.

Mr Davidson makes payments to Mr Howe

38. It will be recalled that on 28 June 2001 Mr Davidson had made a payment of £50,000 to Mr Howe. On 2 November 2001 Mr Davidson made a second payment of £50,000 to Mr Howe and on 23 January 2002 he made a third payment of £75,000 to

Mr Howe.

39. There was considerable dispute at the hearing about whether the three payments by Mr Davidson to Mr Howe were loans or gifts. Mr Davidson said the first two were loans and the third was commission and Mr Howe said that they were all gifts. A decision on this matter is not critical to our decisions on the issues in the references but does have implications for the credibility of these witnesses. On this matter we prefer the evidence of Mr Davidson. We find that the first payment of 28 June 2001 was a loan because, at the time that the payment was made, Mr Howe had only known Mr Davidson for a short time and it is more probable that a new acquaintance would ask for a loan rather than a gift. We do not regard it as conclusive that Mr Davidson did not ask for repayment because Mr Davidson was, and is, a generous man. We also find that the second payment was a loan to meet further acute financial difficulties of Mr Howe. Before the third payment was made the profit on the City Index account had reached about £600,000 and so Mr Davidson reluctantly agreed to transfer half of that amount out of the City Index account so that he would take £225,000 and Mr Howe would take £75,000. The third amount was not, therefore, a loan. Mr Davidson left the two loans outstanding at that time because Mr Howe was potentially entitled to another £75,000 as a percentage of the amount of £300,000 which remained in the City Index account. In the event this profit disappeared and Mr Davidson was not repaid the two loans.

40. In addition to operating Mr Davidson's spread betting account, Mr Howe, and his firm Gilbert Elliott, also acted as broker for Mr Davidson in the purchase and sale of shares in listed companies. Mr Davidson paid Gilbert Elliott the usual commission for these sales and purchases.

City Index and spread betting

41. Having outlined the relevant facts relating to Mr Davidson, Mr Howe and Mr Tatham, we turn to the facts relating to City Index and spread betting. City Index was established in 1983 and we were told that it was a market leader in financial spread betting. At the relevant time City Index had about fifty-five employees and was an authorised person under Part IV of the 2000 Act. Since the enactment of section 63 of the Financial Services Act 1986 (now section 412 of the 2000 Act) spread bets have been lawful and enforceable.

42. When placing a spread bet on a share price the client will either bet that the price will increase (a buy bet) or will bet that the price will decrease (a sell bet). The bet is therefore related to the movement in the price of the shares. As the movement may be up or down the client may win or lose. Before a client of City Index may place a spread bet he has to deposit a sum of money (called margin) which reduces the credit risk taken by City Index should the client lose. The level of margin is a percentage of the value of the notional current underlying position and varies according to the nature of the underlying stock. The lowest rate is 10% for FTSE 100 shares and percentages increase as liquidity decreases. City Index is entitled under its terms and conditions to increase the level of margin at any time. The level of margin required of Mr Davidson in January 2002 was 20% and this was later increased.

43. The price at which a spread bet is booked is linked to the market price of the shares at the time of the bet together with the addition of a charge made by City

Index. In accepting the spread bet City Index is exposed to the risk of a movement in the price of the shares and that risk may be controlled by hedging. Most risks are hedged by reference to the overall risk portfolio but some (including large bets) are hedged individually by a contract for differences. City Index used two counterparties for their contracts for differences, one of whom was Dresdner Securities. When entering into a contract for differences City Index had to maintain margin with the counterparty and also pay commission and interest on the value of the contract for differences. These costs were passed on to the client placing the spread bet through the charge made by City Index. The counterparty was entitled to increase the margin payable by City Index.

44. Most bets on mainstream stocks are completed virtually instantaneously. However, where City Index hedges a bet individually the bet will not be booked until City Index has completed its hedge. If the counterparty itself hedges its exposure by buying the underlying stock then the hedge provided to City Index will depend upon the counterparty being able to purchase the shares. When a client gives an order for a bet he is bound to it from the time that City Index takes the order until City Index either rejects it or accepts it. In practice, City Index will only accept it if City Index can obtain an appropriate hedge. City Index is therefore not bound to the spread bet until its contract for differences is concluded with the counterparty. Once City Index gives an order to a counterparty for a contract for differences it is similarly committed to that transaction to the extent that the counterparty can hedge its position. Thus after a bet is taken it can, in practice, be conditional for some days upon the obtaining of a hedge by City Index and upon the obtaining of its hedge by the counterparty to the contract for differences. This means that City Index does not have to take a bet that cannot be properly hedged and that City Index will not be committed to a contract for differences where the cost cannot be recovered from the client.

45. Most clients express an order to City Index without reference to price. For example, a client might ask for "a buy bet of £100 per point on the shares of X". (Point means penny). This means that every time the price of the shares moves up (or down) by one penny the client gains (or loses) £100. As there are 10,000 pennies in £100, the language used by the client might be "I would like to buy 10,000 shares in X". As mentioned, spread bets work both ways; in the example above the client would win if the shares increased in value but equally he would lose if they decreased. Each spread bet is placed until a stated time after which it can, by agreement, be extended (rolled over) or terminated (closed out). However, a spread bet that is individually hedged can only be unwound, in practice, if there is a market counterparty to the hedge who will buy the stock. Gains from spread betting are tax-free but losses are not tax-deductible. No stamp duty, commission or brokerage is payable in respect of a spread bet.

46. The contractual arrangements between City Index and its clients are contained in its terms and conditions. These state that City Index "offers an "execution only" service and is not registered to give investment advice." Appendix B to the terms and conditions is a risk warning notice. This states that a relatively small movement in the underlying shares can have a disproportionately dramatic effect on a bet. If the underlying market movement is in favour of the client then he might achieve a good profit but an equally small adverse movement could not only result in the loss of the entire deposit (margin) but might also expose the client to large additional loss. The

risk warning concludes by saying that City Index maintained its financial stability by hedging against large bets. Appendix C stated, among other things, that betting was on the outcome of the price of a financial instrument (for example, a share) and that clients were not entitled to the delivery of, or the dividends from, the financial instrument.

47. The business of spread betting on shares operates mainly in relation to listed companies. However, spread bets can be placed in relation to companies whose shares are not yet traded but where the company is about to float. This type of business is called "the grey market". City Index had taken bets on other companies in the grey market before it took a bet on the price of the shares of Cyprotex.

48. Although the size of the spread bet the subject of these references was large, it was not unusual for City Index who undertook transactions of this size for certain clients "on a couple of occasions each month".

49. We accept the evidence of Mr Mansell that, in January and February 2002, no training had been provided to the staff of City Index about the new market abuse regime which had come into force on 1 December 2001.

City Index's counterparty – Dresdner Securities

50. The counterparty for the bet the subject of these references was Dresdner Securities. Dresdner Kleinwort Wasserstein (DKW) is the trading name for the investment bank of Dresdner Bank AG. DKW operates through Dresdner Bank AG, Dresdner Kleinwort Wasserstein Limited, Dresdner Securities and other affiliated and associated companies. Dresdner Kleinwort Wasserstein Limited (Dresdner Limited) acted, among other things, as an investment bank and as an institutional investor. Dresdner Securities did not act as an institutional investor but did offer a range of services to market counterparties, including market making. We accept the evidence of Mr Henderson that some members of the brokerage and investment bank community would understand the difference between shares held by Dresdner Limited on the one hand and shares held by Dresdner Securities on the other but that some experienced users of the market would not understand the difference. The distinction between a holding by Dresdner Securities and a holding by Dresdner Limited is relevant in these references.

51. In arranging a contract for differences Dresdner Securities contracts with another market professional, in this case City Index. At the relevant time Dresdner Securities had four active clients for contracts for differences, of which City Index was one. The rates of commission payable to Dresdner Securities were negotiated periodically with the professional client who also had to deposit margin for a proportion of the value of the transaction. When entering into a contract for differences Dresdner Securities normally attempted to buy the underlying stock as a hedge against its own exposure; however the purchase of the stock was not essential because Dresdner Securities might decide to take the risk themselves, or possibly match the risk with another contract for differences in the same stock. Thus, although Dresdner Securities normally hedged their risk to a contract for differences by buying the shares, they could have sold the shares at any time and hedged their risk in another way. Dresdner Securities would not normally in practice commit itself unconditionally to a substantial contract for differences until it had been able to hedge

its exposure. It is only when Dresdner Securities is satisfied that it will receive the allocation of shares to hedge its exposure that the contract for differences is completed and entered into the computer of Dresdner Securities.

52. The contractual arrangements between City Index and Dresdner Securities were governed by the ISDA Master Agreement of 6 October 1999. This provided, among many other things, that at the end of each business day on which they had agreed to enter into (or cancel) a contract for differences transaction, Dresdner Securities would send City Index a confirmation or cancellation in the form set out as an Annex to the agreement. Entering into a contract for differences in respect of the spread bet the subject of these references was very much part of the normal everyday work of Dresdner Securities.

53. It is standard practice in City Index that the name of their client is not revealed to Dresdner Securities. That name would be regarded as confidential.

AIM

54. As mentioned above, the decision was taken in November 2001 to float Cyprotex on AIM. AIM is the London Stock Exchange's market for smaller growing companies. It was opened in 1995 and by January 2002 more than 950 companies had been admitted to trade and such companies had, collectively, raised more than £7 billion. There was significant investment by institutional shareholders. AIM is regulated by the London Stock Exchange and there are rules which set out the regulatory framework. For a company to be admitted to AIM it must appoint a nominated adviser (called a Nomad) and a nominated broker and must also prepare an admission document.

55. The *Nomad* is responsible for managing the transaction and it co-ordinates the work of the broker and the company's legal and financial advisers. It advises the company as to compliance with the rules of AIM. It confirms the company's suitability for listing and advises on the optimum method of flotation and the flotation timetable. It plays a central project management role and assists the company to select and instruct other advisers and it takes the lead in drafting the admission document. Later the Nomad sees the signed placing letters and checks that the full amount of the placement has been achieved; it then finalises the application for listing and ensures that the company is listed.

56. The Nomad appointed for Cyprotex was Altium Capital Limited of Manchester (Altium). The appointment was evidenced by a letter of engagement sent by Altium to Mr Long of Cyprotex on 1 February 2002. Under the letter of engagement Cyprotex was responsible for keeping Altium informed of all relevant information. Altium had an agency agreement with the broker (Gilbert Elliott) under which the broker was responsible for informing Altium of all information relevant to the placing. We accept the evidence of Mr Adams of Altium that he had only limited contact with Mr Davidson throughout the flotation; although Mr Davidson may have dropped in to meetings he did not usually participate in detailed project-related discussions. We also accept the evidence of Mr Adams that, although he rarely spoke to Mr Davidson, he did speak to Mr Mark Warburton of Addleshaws, who were the solicitors for Cyprotex.

57. The role of the *broker* in the placing is to provide an interface between the company and the investment community. The broker advises on stock market conditions and investor appetite for the company and arranges meetings with existing and potential investors. The broker works closely with the board of the company to co-ordinate introductions to selected investors and is responsible for communicating the progress of the placing to the board and to the Nomad. It also advises the company and the Nomad on the placing price. The broker, as agent for the company, enters into contractual commitments with proposed new investors (the placees) by sending them placing letters which set out the number of shares which will be issued to individual placees by the company and which also set out the funding commitment required from the placees. The broker is also responsible for the allocation of stock if the placing is over-subscribed. The broker has a duty to report to the Nomad throughout the placing process especially during the marketing phase.

58. The broker for the Cyprotex admission was Gilbert Elliott and the person dealing with the matter at Gilbert Elliott was Mr Howe. This was the first time that Mr Howe was instructed on a flotation, although he had been involved with the private placement for Sense-Sonic some months before. A formal confirmation from Gilbert Elliott that they would act as the nominated broker was signed on 13 December 2001. Gilbert Elliott's fees were to be 3% of the total money raised by the placing. (Mr Howe's bonus of £46,500 was payable to him by Gilbert Elliott only if the flotation succeeded).

59. The *admission document* or Prospectus for Cyprotex was drafted by Altium. Under AIM rules, responsibility for the information contained in the Prospectus lay with the company and its directors. It is expected that the Prospectus will be repeatedly reviewed and corrected by the directors, the lawyers, the accountants, the Nomad and the broker. The lawyer verifies the details of the Prospectus and the accountants produce the financial information. The directors of the company take joint and several responsibility for compliance with the rules of AIM and for providing confirmation that no material information has been omitted. Mr Long was the director at Cyprotex who was primarily involved with the flotation.

60 A draft, or "pathfinder", Prospectus for Cyprotex was published on 12 December 2001. The Prospectus stated that the placing was not underwritten and that a condition of the admission of the ordinary shares to trading was that the full amount of the subscription was to be raised through the placing. We accept the evidence of Mr Adams that, if the full amount to be raised was not placed, then the process would be cancelled. Thus the admission of Cyprotex to AIM was then conditional on a placing of £11 million worth of shares being achieved in full. At that time admission was to be on 10 January 2002.

61. It is common at the time of a listing for the Nomad, or the broker, to require lock-in arrangements from major shareholders and directors of the company. A lock-in arrangement prevents the sale of shares for a period of time after flotation in order to minimise the risk of there being an over supply of shares immediately after flotation which could lead to a fall in the market price of the company. In the Cyprotex flotation there were lock-in arrangements in respect of Mr Davidson, as the principal shareholder, and of some of the directors.

The progress of the Cyprotex flotation

62. It will be recalled that in November 2001 the decision had been taken to float Cyprotex on AIM. On 1 December 2001 the new market abuse regime came into force.

63. On 10 December 2001 Mr Howe prepared a list of about twenty-eight prospective investors and sent it to Mr Adams at Altium with a request that copies of the pathfinder Prospectus be sent to the prospective investors. Thereafter Mr Howe, Mr Long and other directors visited the prospective investors and presentations were made. The response was lukewarm. At this time Mr Long was keeping Mr Davidson informed about the progress of the placement but there was no formality – Mr Long would speak to Mr Davidson on a random basis which would be about once a week when they saw each other. Before Christmas 2001 Mr Long told Mr Davidson that it would be impossible to raise £11 million. We accept the evidence of Mr Long that the aim then was to re-group in the New Year; to set the sights lower; and do some more marketing.

64. On 2 January 2002 Mr Nicholson of Cyprotex sent an email message to the members of the board to say that the board meeting fixed for 7 January 2002 to approve the entry to AIM had been postponed. He said that there had been seventeen meetings before Christmas with more than twenty fund managers but support was just under £3m. On 4 January 2002 Mr Howe sent a summary of fourteen responses to Altium; most responses were negative and the general view was that the company had been brought to the market too early. However, HSBC were ready to subscribe £650,000 and Gartmore were ready to subscribe £250,000. Altium then arranged some meetings with venture capital trusts in the North West.

65. On or before 8 January 2002 the board of Cyprotex decided to reduce the amount of the placing from £11 million to £6.5 million and to delay the flotation. Mr Davidson was informed. Some further marketing was arranged and the presentations given by Cyprotex to prospective investors were altered. We accept the evidence of Mr Howe that the reduction in the amount to be raised in the placing had to be agreed with the Nomad and the board of Cyprotex; in January 2002 it was possible to reduce the amount but, once placing letters had been sent out, the amount could not easily be changed. At about this time Mr Long met Mr Davidson by chance and Mr Davidson told him that he, Mr Long, had been unsuccessful with the placing and that he, Mr Davidson, "would come in and finish the job". We accept the evidence of Mr Long that this was "probably bravado".

The Clubhaus spread bet

66. At this stage we have to turn from the marketing of the Cyprotex placement and refer to the Clubhaus spread bet which became relevant on 7 January 2002.

67. From about August 2001 Mr Davidson had been acquiring shares in a company called Clubhaus which had interests in golf clubs and country health clubs. On 21 September 2001 (the day after Mr Davidson had signed the authority to trade letter) Mr Howe, on behalf of Mr Davidson, placed a "buy" spread bet with Mr Tatham at City Index for 2.5 million Clubhaus shares at 7.5 pence. City Index decided that they wanted to hedge this bet as it was in respect of a small company and so Dresdner Securities were approached. Dresdner Securities entered into a contract for

differences and then purchased the shares to hedge their exposure. On 7 January 2002 an extraordinary general meeting of Clubhaus was to take place at which Mr Davidson wished to vote. On 4 January 2002 Mr Howe asked Mr Tatham and Mr Tatham asked Dresdner Securities if Mr Howe could vote as Mr Davidson's proxy in respect of the shares purchased by Dresdner Securities. Mr Howe then assumed that Mr Davidson was the beneficial owner of the shares but was informed by Mr Tatham that the beneficial owner of the shares was Dresdner Securities and so Mr Davidson could not vote in respect of the shares. On the day of the extraordinary general meeting Mr Howe closed out the spread bet and his firm (Gilbert Elliott) purchased the shares from Dresdner Securities for Mr Davidson to enable him to vote.

68. Later that day (7 January 2002) Mr Howe asked Mr Tatham: "If we again need to warehouse some more shares with a view to doing a later transfer you can pick them up through [Dresdner Securities] can't you by a transfer to Gilbert Elliott?" to which Mr Tatham replied that that would be no problem. Mr Howe remarked that this was "slightly more clandestine" if the shares were the subject of a spread bet and were later transferred to Gilbert Elliott. Later on the same day (7 January 2002) Mr Howe told Mr Tatham that he wanted Mr Tatham "to start building now" and gave an order to "buy" six million shares in Clubhaus which would take Mr Davidson's stake up to ten per cent. Mr Howe said that he did not want the arrangements "to get out". We accept the evidence of Mr Tatham that he personally had no intention to conceal anything. He referred to Mr Howe's comments as "classic Nigel Howe – he makes all these sort of clandestine comments all the way through – he comes out with these clandestine comments the whole way".

The meetings with Mr Cooke of Dresdner Limited and with Credo

69. We now return to the progress of the Cyprotex placement and it will be recalled that, on or before 8 January 2002, because of a lukewarm response, it had been decided to reduce the amount of the placing from £11 million to £6.5 million and some further improved marketing was arranged.

70. Mr Cooke of Dresdner Limited had previously been introduced to Mr Davidson by Mr Howe and had met him on a number of social occasions. In early January 2002 Mr Cooke met Mr Howe for a drink in a public house and Mr Davidson was also there. The three of them had an informal discussion about the forthcoming Cyprotex placing. Mr Cooke was told that there had been a mixed reaction from investors and that some thought that the prospects of the company becoming profitable were too far off to warrant investment. Mr Cooke told Mr Howe and Mr Davidson that they needed to target a specific investor base and suggested that they concentrate on those funds that invested in healthcare stocks. Mr Cooke made it clear that Dresdner Limited would be unlikely to be interested in that kind of investment.

71. On or about 21 January 2002 there was a meeting at Addleshaws and both Mr Long and Mr Davidson were present. A decision was made to proceed on the basis that the date for the flotation and the placing was to be 12 February 2002. Those attending the meeting thought they could raise £6.5 million and, according to Mr Long "some big numbers were being bandied around" and "the numbers we were looking for seemed to be about right". Mr Davidson said that he personally would put in some more capital and subscribe for shares but was told by Mr Holmes that he

could not do that because technically that would have been an acquisition.

72. At about, or shortly after, this time Mr Nicholson told Mr Davidson that they were struggling to reach £6.5 million. Mr Davidson therefore decided to come to London to see how things were progressing. A meeting had been arranged for 23 January 2002 to meet Mr Cooke of Dresdner Limited and to ask his guidance. That meeting was attended by at least Mr Davidson, Mr Howe, Mr Long, and Mr Cooke and possibly also by a lawyer from Addleshaws. Mr Long gave Mr Cooke a shortened form of the presentation which had been given to other prospective investors. Those attending had different impressions at the end of the meeting. Mr Cooke said that he made it clear that he would not invest. Mr Long came away from the meeting without any conclusive view as to its outcome but was not clear that Mr Cooke did not want to subscribe for shares. Mr Davidson told us that "it was a funny meeting – he did not say he would not invest" but "there was no commitment whatsoever; sometimes there is no commitment on the day; people think about it and they say something and they come back and try and get the shares a bit cheaper." We accept that all these impressions were subjectively genuine.

73. However, Mr Cooke did decline to subscribe for shares because he did not think that it would be an appropriate investment for Dresdner Limited. Instead he gave Mr Howe the names of some healthcare funds which might be interested.

74. Shortly after the meeting with Mr Cooke there was another meeting in the bar at the Dorchester Hotel attended by Mr Davidson, Mr Howe and Mr Long for Cyprotex and Sir Anthony Jolliffe and Mr Tredoux of Credo Corporate Finance (Credo). Sir Anthony or Mr Tredoux indicated that, subject to due diligence, Credo would be likely to invest £500,000 in the placement. Mr Davidson also worked on a "Chairman's List" of possible non-institutional investors. However, by late January 2002 it was Mr Howe's view that the placement was "in real trouble". Mr Long told Mr Davidson that the placing was under-subscribed but Mr Davidson believed that other investors would "come in". We were told that there were two other possible investors, one of whom was Russian and the other was interested in smallpox.

The arrangements for the Cyprotex spread bet

75. We now come to the events of 28 January to 15 February 2002. We have to describe these events in some detail because they were relied upon by the Authority as evidence from which we should infer that Mr Davidson, Mr Howe and Mr Tatham acted in agreement to ensure that the placing was facilitated by a spread bet and that all three (Mr Davidson, Mr Howe and Mr Tatham) were aware (or agreed) that the spread bet would not be disclosed. Mr Davidson argued that the bet had been placed by Mr Howe and that he (Mr Davidson) had thought that the bet was not related to the placing but to the price of the shares in the aftermarket. Mr Tatham argued that all he had done was to effect a spread bet and that he had no agreement of any sort with Mr Davidson or Mr Howe.

Monday 28 January 2002 – the early conversations

76. We recall that on 23 January 2002 Mr Davidson had paid Mr Howe the third payment of £75,000 as a percentage of gains made on spread-betting.

77. At 09.18 am on Monday 28 January 2002 Mr Davidson telephoned Mr

Tatham. As the terms of this telephone conversation were relied upon by the Authority we set out the relevant extracts from the transcript of the tapes:

> "Mr Davidson: If I want to buy stock in an AIM company, the day it floats, can you do that?
>
> Mr Tatham; Yes, sure, no problem
>
> Mr Davidson; It's a company that I've got a major shareholding in the other side and I want to buy £3 million worth of stock. And that so its going to be in the placing document then it would be well, it wouldn't be in the placing document but it would be that such stock have to be covered, how much do I have to send you?
>
> Mr Tatham: What sort of capitalisation the stock going to be?
>
> Mr Davidson: The company will be for £33 million on day one but we know what it's really worth.
>
> Mr Tatham: Right
>
> Mr Davidson: That's why I want to get on both sides.
>
> Mr Tatham: Right OK it's probably going to be about 20% margin on that, so it will be £600,000.
>
> Mr Davidson If I send you £600.000 today
>
> Mr Tatham: Yeah
>
> Mr Davidson: It'll be today, it might be next week we might do the deal.
>
> Mr Tatham: OK fine yeah."

78. The call concluded with the suggestion of a meeting to discuss matters but in fact no meeting took place.

79 Mr Davidson then spoke to Mr Howe and said that he intended to take legal advice. Later on 28 January 2002 Mr Howe telephoned Mr Tatham and asked him if he knew what Mr Davidson wanted to do. Mr Tatham replied that Mr Davidson wanted to buy ten per cent of "some sort of placement". Mr Howe then said that he was doing the placement and the company was one in Mr Davidson's "stable". Mr Davidson was not on the board but was the largest shareholder. The placing was probably going to go live and start dealing on 12 February 2002. Mr Davidson wanted to take 3 million pound's worth of stock which was effectively ten per cent of the company and "wants to take the placement through CFD [contract for differences]". There was then a discussion about whether that would take Mr Davidson's shareholding above thirty per cent. This was probably a reference to the Rules of the City Code on Takeovers and Mergers (the Takeover Rules). Then Mr Howe asked to whom he should send the placing letter and Mr Tatham said to Dresdner Securities. There was some discussion about whether a contract for differences could take part in a placement. Both agreed to discuss the matter further at a later time; Mr Tatham remarked that, when he had spoken to Mr Davidson he, Mr Tatham, "did not get the full picture".

80. Later on 28 January 2002 Mr Tatham telephoned Mr Starbuck at Dresdner Securities and asked if the proposal was "doable". Mr Starbuck was of the view that

there was no problem in principle with Dresdner Securities entering into a contract for differences referenced to a placing; nevertheless he warned that he had tried to hedge a contract for differences by buying shares in a placement on previous occasions but the brokers in charge of the placement letters did not see him as a prime client because of his position as a market counterparty. Mr Tatham assured Mr Starbuck that he thought he "can get round that", no doubt bearing in mind that the Cyprotex placement would be controlled by Mr Howe who would make sure that Dresdner Securities would get its placing letter. At no stage in the transaction was Mr Starbuck, or Dresdner Securities, informed that Mr Davidson, the principal shareholder of Cyprotex, was the client of City Index on whose behalf the spread bet would be placed. However, that was in accordance with normal procedures; City Index did not divulge the names of their clients.

Monday 28 January 2002 - the legal advice

81. Also on the morning of 28 January 2002 Mr Davidson visited his lawyer, Mr Holmes of Addleshaws. There was a conversation during which Mr Davidson asked for general advice about spread betting without mentioning Cyprotex. Mr Holmes asked Ms Prys-Picard to prepare a draft letter of advice in relation to transactions carried out by Mr Davidson with City Index. Ms Prys Picard asked Mr Holmes for the context within which the advice was required. Mr Holmes told her that Mr Davidson wanted general legal regulatory advice where someone engaged in a business would place a bet with City Index who would hedge the bet by buying shares in the market to hedge their position but where the person placing the bet would not be involved with the hedging arrangements. Mr Holmes continued by saying that the sort of thing to be mentioned in the letter would answer the question whether the person placing the bet would ever be in a position where they would have to place a mandatory bid if their interest went over 30%. Ms Prys-Picard suggested that the letter should also address issues like market abuse and insider trading. Mr Holmes did not mention that the draft letter would have anything to do with Cyprotex. Ms Prys-Picard thought that the bet referred to was one being placed on a company with which Mr Davidson had no association.

82. Ms Prys-Picard prepared a draft letter on 29 January and left it for review by Mr Holmes. Mr Holmes amended the draft and during the next day it was finalised and given to Mr Warburton to give to Mr Davidson. Mr Davidson said he received it on 31 January or 1 February. The letter was in general terms and was based on a number of stated assumptions. Mr Holmes added a fourth assumption to Ms Prys-Picard's three. The fourth assumption was:

> "that the only understanding that you have with City Index is the placing of the bet in accordance with City Index's terms and conditions. If you have separate understandings or agreements with them, for example, agreeing with them the manner in which they will hedge your bet, that may change the advice given below."

83. The letter was thorough and lengthy and contained sound advice on the market abuse regime. However, it did not refer to Cyprotex and it did not specifically address any specific proposed spread bet. Nevertheless, the letter did indicate that a pre-agreed hedge could be an area of difficulty and suggested that Mr Davidson should seek further legal advice prior to placing a bet as each case would be determined on

its own facts. We regard it as relevant that subsections (1) to (2) and (5) to (9) of section 118 of the 2000 Act came into force on 1 December 2001 (the other subsections coming into force on 25 February 2001). Thus at the relevant time the legislation was new and untested.

T***uesday 29 January 2002 – the size of the bet increases to £4 million***

84. On 29 January 2002 at 08.23 am Mr Tatham spoke to Mr Howe and confirmed that the placing letter could be sent to Dresdner Securities. Mr Howe pointed out that Dresdner Securities would have to pay the full amount for the stock of the company whereas Mr Davidson would only be putting up the 20% margin. He added that the placing letters would probably go out on 12 February. Mr Howe said that he would inform Mr Davidson that all was well. There was also some discussion about whether Mr Davidson's bet would result in his holding more than 30% of the shares in Cyprotex and the effect of that on the Takeover Rules.

85. Later the same day (29 January 2002) at 08.48 am Mr Howe spoke again to Mr Tatham and said that he had spoken to Mr Davidson who now wanted to take four million pounds worth of shares through Dresdner Securities and would like to put up £800,000 (as margin). Mr Howe asked Mr Tatham to clear with Dresdner Securities that they would get a placing letter from Mr Howe and that they were ready for a "full AIM Listing". Almost immediately Mr Tatham spoke to Mr Starbuck at Dresdner Securities and told him that the contract for differences would be for £4 million worth of stock and that the placement letter would be sent to Mr Starbuck. The company would be an AIM company that was not yet floated; it was called Cyprotex. That appears to be the first mention of the name of Cyprotex in the taped telephone calls. Mr Starbuck appeared not to know how the mechanics of dealing with a placing letter worked but felt that was a function for his back office and, so long as he was allocated the stock, that was fine. Mr Starbuck was not told that City Index's client was Mr Davidson but that was in accordance with usual procedure. Mr Starbuck must have appreciated, even if he was not specifically told, that the contract for differences was required to hedge a spread bet.

86. On 29 January Mr Tatham spoke to Mr Mansell of City Index about Mr Davidson's proposed spread bet on the shares of a company which was about to float and in which Mr Davidson was a significant shareholder. It was a large trade in terms of the percentage of the company. Mr Tatham was concerned that the spread bet might be the equivalent of giving Mr Davidson a holding of more than 30% in the company. Mr Mansell then knew that there was a placing and expected that the bet would be hedged by Dresdner Securities who would take stock in the placing. Mr Tatham may have mentioned that Mr Howe was involved as well. Mr Mansell was not told that the success of the placing was linked to the spread bet nor was he told of the percentage of the placing involved in the bet nor was he told that the bet was being used "to get the placing away". Mr Mansell asked Mr Tatham to check the legal and regulatory details of the transaction. Mr Tatham concluded that City Index would not breach the terms of the Takeover Rules and would have no disclosure obligations because neither City Index nor Mr Davidson would be trying to buy the company. Later Mr Tatham told Mr Mansell that Mr Davidson had a legal opinion that the trade was in order and Dresdner Securities, who were hedging the spread bet, were comfortable in being involved with the transaction.

87. Later still on 29 January 2002 (at 9.43 am) Mr Howe spoke again to Mr Tatham. Mr Tatham mentioned that he had had a chat with Mr Mansell of City Index and wanted to know if Mr Davidson was going to take all the placing to which Mr Howe replied that he would take just over half and that the placing was "oversubscribed now" and Mr Davidson might have to be scaled back from £4 million out of £6.5 million. He added "There's no way Paul [Mr Davidson] wants to do anything that can be anyway deemed illegal. It's completely on side." Mr Howe went on to say that "we should have thought of this earlier because we were struggling with this placing a bit and of course this is a naturally easy way to get it away. We've got two more of his vehicles coming to the market in the next six months infinitely larger than this and you can imagine the fun and games we're going to have with those now." There was further discussion about the takeover issue.

Tuesday 29 January 2002 – "Cookie has stepped up to the plate"

88. At some time before 12.04 pm on 29 January 2002 Mr Howe was reported as telling Mr Long in his usual colourful language that "Cookie has stepped up to the plate". Being translated that meant that Mr Cooke of Dresdner Limited had subscribed for the requisite amount of the shares to complete the placing. (The phrase "step up to the plate" appears to be derived from the game of baseball where it means to move into position to hit the ball). At about this time Mr Howe also informed Mr Adams of Altium that Dresdner Securities would be investing in the placing and also stated (incorrectly) that they were purchasing stock with a view to selling it on to institutions post-flotation. Mr Adams at that time did not appreciate that there was any distinction between Dresdner Securities and Dresdner Limited.

89. On 29 January 2002 at 12.04 pm Mr Nicholson of Cyprotex sent an email to the directors of Cyprotex to say that the funding of £6.5 million had been secured through Dresdner Securities, HSBC, Gartmore, Credo, Chairman's list and one other subscriber and that it was possible that the listing day might be brought forward from 12 February 2002. It had been decided to authorise £11 million shares but to limit the issue to £6.5 million. On the evidence before us we find that the person who informed Mr Nicholson that the funding had been secured by the inclusion of Dresdner Securities was most probably Mr Long.

90. Much later on 29 January 2002 (at 15.14 pm) Mr Howe spoke to Mr Tatham to say that "impact day" would almost certainly be 12 February. It looked as if £6.5 million was being raised but "we've probably already got eight in the bin so it may be that Paul or Dresdner will not be taking as much as we envisaged". At 7.15 pm on 29 January 2002 Mr Paul Lines of Altium sent an email to the directors of Cyprotex, Addleshaws, Mr Howe, and the lawyers for Altium, referring to a meeting held earlier that day and sending them a timetable for the flotation.

91. Also at about this time Mr Davidson again met Mr Nicholson and said something to the effect that "Dresdner are going to invest – we've done it, we've cracked it". Mr Davidson put it to Mr Nicholson in cross-examination that the reason that Mr Davidson had said that was because he (Mr Davidson) had received the same information and Mr Nicholson agreed that that was a reflection of what he recalled. We accept that evidence of Mr Nicholson.

Wednesday 30 January 2002 – compliance consultations within Dresdner Securities

92. On 30 January 2002 at 10.13 am Mr Tatham spoke to Mr Starbuck at Dresdner Securities to say that the placement was going to go live "possibly by the end of the week" and the lead manager wanted to send the placing letter to Dresdner Securities and needed a name and address. Mr Starbuck was unfamiliar with the concept of a placing letter and said he would have a word with his back office team to see if anyone knew what to do.

93. At 2.39 pm Mr Howe spoke to Mr Tatham and said that he was sending out the placing letters on Cyprotex the next day. £6.5 million had been raised of which Mr Davidson, through Dresdner Securities, was going to take £4 million; Mr Davidson would put up initial margin of £800,000. Mr Howe went on to say that he would need the name of the person at Dresdner Securities to whom he should send the placing letter.

94. Meanwhile within Dresdner Securities there was a significant amount of consultation with the compliance, legal, credit and business analysis departments. At 5.25 pm on 30 January Mr Starbuck asked for advice and was told about placing letters and the procedures and how they should be signed. At 5.32 pm Mr Starbuck spoke to Mr Tatham and said that he would prefer a more straightforward way of acquiring the shares as the placing letters were complicated and "had to go through legal".

Thursday 31 January 2002 – the size of the bet increases to £5 million maximum

95. Early on the morning of 31 January 2002, at 8.40 am, Mr Howe spoke to Mr Tatham who suggested that Dresdner Securities would rather acquire the shares in a manner other than in the placement but Mr Howe said that he needed to send the placing letter to Dresdner Securities. At 8.44 am Mr Tatham passed this information to Mr Starbuck and almost immediately spoke to Mr Howe to tell him to send the placing letter to Mr Starbuck at Dresdner Securities.

96. At 3.00 pm the same day Mr Howe telephoned Mr Tatham to ask how much margin Mr Davidson had with City Index because Mr Davidson was going to lodge the money for the margin for the Cyprotex bet the next day. At 3.45 pm Mr Tatham called Mr Howe to say that Mr Davidson had £200,000 and so would need to lodge another £800,000. Mr Howe mentioned that Mr Davidson would be taking shares worth £5 million out of £6.5 million as an absolute maximum and for that would need to put up £1 million. However, if Mr Davidson took £4.5 million then he would transfer £800,000. Mr Howe went on to say that Mr Davidson was going on holiday the following Tuesday (5 February) and would transfer the money the next day and that dealings in Cyprotex shares would start on 15 February. By the end of the conversation it was agreed that it would be easier if Mr Davidson transferred a straight £1 million to City Index and that Mr Howe would send a placing letter to Mr Starbuck with a copy to Mr Tatham. Mr Starbuck would return the signed placing letter to Mr Howe with a cheque for £5 million. The conversation made it clear that the exact amount of shares in the placing letter to be sent to Dresdner Securities depended upon amounts to be subscribed by other placees. At the end of the conversation Mr Howe mentioned that Oystertec were about to have a rights issue and that he might wish to undertake a "similar exercise" with that. Mr Howe also spoke to Mr Long on 31 January 2002.

97. On 31 January Mr Warburton retired from Addleshaws and thereafter worked for Mr Davidson at Galileo as Mr Davidson's personal lawyer.

Friday 1 February 2002 - the prospectus

98. At 10.51 am on 1 February 2002 Mr Howe telephoned Mr Tatham and asked him to call Mr Davidson at his bank to discuss the transfer of the margin. Mr Howe said that he would send Mr Tatham a copy of the placing letter but he would not officially copy it from Gilbert Elliott. (We accept the evidence of Mr Howe that the reason why the copy was not sent officially from Gilbert Elliott was because Mr Howe did not want anyone at Gilbert Elliott to know that a spread bet with City Index had anything to do with the flotation.) At 10.52 am Mr Tatham did speak to Mr Davidson and gave him the details of City Index's bank account. At 12.19 pm on the same day Mr Howe spoke to Mr Tatham who confirmed that he had spoken to Mr Davidson who would be transferring £1 million. Although Mr Davidson was going on holiday the following Tuesday for a week he, Mr Howe, would be speaking to him every day. Mr Howe said that the placing letters would be going out that day and a copy would be sent to Mr Tatham.

99. On 1 February 2002 an updated version of the Prospectus was prepared (called a placing proof). It was entitled "Cyprotex PLC – Placing and admission to trading on AIM". It referred to the placing of 22,413,793 ordinary shares at 29p per share and stated that the authorised share capital immediately following the placing would be 160,000,000 ordinary shares of 0.1p each (£160,000) of which £90,413,793 (£90.413.79) would be issued and fully paid. The Prospectus contained the names of all persons, other than the directors, who immediately following admission would be interested in three per cent or more of the issued share capital. Mr Davidson headed the list with 37,750,000 shares which was 46.69% of the issued share capital before admission and 35.12% after admission.

100. On 1 February Gilbert Elliot prepared a schedule of placees in the Cyprotex placing; the schedule included the name of Dresdner Securities for the consideration of £4,467,244.97. Also on 1 February 2002 Gilbert Elliott prepared a placing letter, addressed to Mr Starbuck at Dresdner Securities, in respect of 15,404,293 shares at the price of £4,467,244.97. The placing letter indicated that the issue of the placing shares would not be underwritten and that participation in the placing was conditional upon confirmation being received from all other placees. The letter went on to say that, by signing and returning the form of confirmation, Dresdner Securities would have a legally binding obligation to subscribe for the number of placing shares indicated. The letter also stated that allotment of the placing shares was expected to occur, conditionally upon admission taking place, on 7 February 2002 and trading in the placing shares was expected to commence on 15 February 2002. The price of the shares was to be paid in full to the registrars of the company. [The letter of confirmation in respect of this placing was signed on behalf of Dresdner Securities on 6 February 2002.]

101. In December 2001 Mr Long had opened a spread betting account with City Index. On 1 February 2002 Mr Long wrote to Mr Ticehurst of City Index to confirm that Mr Howe was entitled to trade on Mr Long's account with City Index.

Monday 4 February 2002- the first placing letter

102. At 9.35 am on Monday 4 February 2002 Mr Starbuck of Dresdner Securities spoke to Mr Tatham to say that he had just received the draft prospectus for Cyprotex (but no placing letter) and £4 million was more than half of the whole placing of Cyprotex and he was going to talk to his compliance department. A little later, at 9.52 am, Mr Tatham spoke to Mr Davidson who said that the transfer of the margin money had been done but would arrive the following day. Mr Tatham said that he thought they had a few days as nothing would happen until the end of the week. Mr Davidson remarked that he still "had a bit of headroom" if Mr Howe wanted to spend some money while he was away.

103. At 10.17 am Mr Howe spoke to Mr Tatham and told him that a placing letter had been "biked over" to Mr Starbuck and he would fax a copy to Mr Tatham. There was some discussion of the Takeover Rules because Mr Davidson already owned 35% of the shares and would be taking a interest (through the spread bet) in another 15% and Mr Howe suggested that, if Mr Davidson needed to stay below 50%, Dresdner Securities could still sign the contract for differences but a part could be used by City Index to hedge a bet by another customer. Mr Tatham remarked that Dresdner Securities would not know who had placed the spread bet. At 10.28 am Mr Howe personally sent a copy of the placing letter to Mr Tatham by facsimile message; it arrived at City Index for Mr Tatham under cover of an official Gilbert Elliott headed page.

104. On the morning of 4 February Mr Starbuck of Dresdner Securities had discussions with Mr Bradley of his compliance department when it was confirmed that Dresdner Securities would only accept a contract for differences up to the amount of stock that they were given in the placement. At 1.23 pm Mr Starbuck spoke to Mr Tatham to say that he had received the placing letter and Mr Tatham asked that it be signed and returned to Mr Howe by noon on Wednesday (6th February). Mr Howe spoke to Mr Davidson at 12.46 pm and 1.11 pm on 4 February.

Tuesday 5 February 2002 – Mr Davidson goes to Barbados

105. Mr Davidson left for a holiday in Barbados on 5 February. We accept his evidence that by mistake he left his mobile telephone in the airport departure lounge and so could not make or receive any calls on it while he was away. We also accept his evidence that, while he was on holiday, calls could be put through to him at his hotel if the caller first called Oystertec and asked to be put through. The switchboard manager at Oystertec was Christine and Christine was Mrs Davidson's sister.

106. On 5 February Mr Starbuck spoke to the Dresdner Securities legal department about the placing agreement and later Mr Davidson spoke to Mr Tatham to say that he was flying to Barbados that day. He said that the margin money was on the way to City Index from his bank and trading would start the next Friday. At 1.37 pm Mr Tatham spoke to Mr Starbuck who said that the placing letter had had to be signed by a senior person at Dresdner Securities.

Wednesday 6 February 2002 – the first placing letter is sent to Mr Howe

107. On 6 February 2002 the placement letter for 15,404,293 shares at the price of £4,467,244.97 was signed on behalf of Dresdner Securities and sent to Mr Howe.

Wednesday 6 February 2002 – the withdrawal of Credo

108. Also on 6 February 2002 Sir Anthony Jolliffe spoke to Mr Long to say that, having undertaken due diligence, Credo would not be taking any part in the placing. That meant that the placing became under-subscribed. At 12.09 pm on 6 February Mr Howe called Mr Tatham to say that he had received the signed placing letter from Dresdner Securities but had had a crisis. One of the proposed investors in the placement (Credo) had pulled out at the last minute. He said: "I was oversubscribed by £600,000 now I'm obviously £500,000 short"; for that reason he wanted the spread bet to be the full £5 million and he asked if he should get a new placing letter to Dresdner Securities or a subsidiary one for £480,000. Mr Tatham thought that a subsidiary letter would do and that the margin in Mr Davidson's account was sufficient. Mr Howe asked Mr Tatham to speak to Mr Starbuck. Mr Tatham then spoke to Mr Starbuck to say that City Index were applying for another £500,000 worth of shares and that another placing letter was on the way. In the event a second placing letter for £480,000 shares was "biked round" to Mr Starbuck that day.

109. At 12.57 pm United Kingdom time Mr Davidson in Barbados called Mr Howe and spoke to him for four minutes and thirty-one seconds. There was a dispute about the purpose of this call which we consider below.

110. At 4.55 pm Mr Howe spoke again to Mr Tatham from the City Tup. As transcribed this conversation did not make a great deal of sense but it was clarified in oral evidence by Mr Howe. Mr Howe said that, following a change of ownership, his employer's guidelines had changed and he could no longer spread bet on his own account. However, he had the amount of £8,000 on his account at City Index as an introduction fee for introducing Mr Davidson. Mr Howe wanted to use the £8,000 as margin for a bet in the name of Mr Long, the bet being on Cyprotex shares and made on the basis that if there were a gain Mr Howe would retain his £8,000 and Mr Long would take the gain. Later Mr Howe visited Mr Tatham and brought round an authority to trade on Mr Long's account.

111. On the same day Mr Starbuck spoke again to Mr Bradley in the Dresdner Securities compliance department and raised a number of compliance issues including credit and legal issues. There was a concern that, with the second bet, Dresdner Securities would be holding a large proportion of the shares in Cyprotex. Mr Starbuck also spoke to the credit department.

112. At about this time Gilbert Elliott prepared another placing latter addressed to Mr Starbuck in similar terms to the first except that it referred to 1,655,172 placing shares at the price of £479,999.88.

Thursday 7 February 2002 – Dresdner Securities sign the second placing letter

113. The discussions within Dresdner Securities continued on 7 February when the view was formed that Dresdner Securities would enter into another contract for differences and buy the further amount of shares but in return would be asking for double margin on the whole exposure for both bets. It was noted that the client of City Index who was placing the bets was only putting up margin of 20% and was using Dresdner Securities' balance sheet to invest in a company which was making that company look "very frothy". At about this time Dresdner Securities referred the matter to their office in Frankfurt because of the percentage of shares in the company which they were going to acquire.

114. At 3.26 pm Mr Starbuck spoke to Mr Tatham to tell him that the margin rate had been increased to 44%. Mr Tatham said that he would still have to do the bet because he had told the client he would do it. Also he had told the client about the amount of margin required and he could not change that for the time being so City Index would "wear" the increase themselves. At 3.34 pm Mr Howe spoke to Mr Tatham and Mr Tatham explained that Dresdner Securities had doubled its margin. Mr Howe indicated that this could be taken into account in the price of the shares at which the bet was booked. Mr Howe emphasised that he needed to receive the second placing letter from Dresdner Securities.

115. At 3.41 pm Mr Tatham spoke to Mr Starbuck and asked if the placing letter would be returned that day. At 4.17 pm Mr Howe spoke to Mr Tatham again and said that Mr Davidson had been enquiring from Barbados about the situation. The flotation depended upon the second spread bet and Mr Howe was still £480,000 "light". As the credit office at Dresdner Securities had agreed the deal Mr Tatham agreed that Mr Howe could inform Mr Davidson that all had been completed. Mr Tatham said that he had consulted Mr Mansell and that the increased margin charged by Dresdner Securities would be reflected in the price at which the bet was booked to Mr Davidson; discussion also took place about the term of the bet.

116. On 7 February there was also a meeting at City Index between Mr Howe and Mr Tatham about an account for Mr Long and at this meeting Mr Howe mentioned to Mr Tatham that Mr Davidson had taken legal advice in relation to the spread bet and that the solicitors "were comfortable with it". Mr Tatham did not ask to see a copy of the legal advice.

Friday 8 February 2002- the second placing letter is sent to Mr Howe

117. On 7 February 2002 the second placement letter for 1,655,172 shares at the price of £479,999.88 was signed on behalf of Dresdner Securities. At 9.25 am on 8 February Mr Tatham spoke to Mr Howe to say that the second placing letter had been signed on behalf of Dresdner Securities and would be faxed to Mr Howe that day. .

Monday 11 February 2002 – the Reuters Article

118. On Sunday 10 February Mr Knight, the managing director of Gilbert Elliott, returned from holiday and was told that Dresdner "had stepped up to the plate" by taking stock in the Cyprotex placing. He later discussed the matter with Mr Howe. Mr Knight assumed that Dresdner had taken the stock as an institutional investor and Mr Howe did not seek to correct that assumption.

119. On Monday 11 February 2002 there was a Reuters News Service article which stated that Cyprotex would float on the following Friday. The article stated that Cyprotex had said that it had placed about 25% of its shares with institutional investors at 29 pence each giving it a market capitalisation of about £26.2 million. At that time Mr Howe had not informed the company that Dresdner Securities had taken the shares to hedge a contract for differences and he led the company to believe that Mr Cooke of Dresdner Limited had decided to invest.

120. Also on 11 February 2002 Mr Howe spoke to Mr Tatham and said that he, Mr Howe, had just spoken to Mr Davidson in Barbados who was very happy. Mr Howe

referred to the transfer of Mr Davidson's stock (worth about £10 million) in Oystertec where his lock-in arrangements were to cease on 21 February. The proposal was that a spread bet would be placed which would be hedged by a contract for differences the counterparty of which would purchase Mr Davidson's holding of shares and that would be a more tax efficient vehicle. Mr Howe invited Mr Tatham to a meeting in Manchester on Monday 18 February when Mr Davidson was to be back from Barbados.

Tuesday 12 February 2002 – the placing agreement

121. On Tuesday 12 February 2002 a Placing Agreement between Cyprotex, the directors of Cyprotex, Altium and Gilbert Elliott & Co Limited was signed. Clause 3.5 provided:

> "The Company and each of the Directors agree that every significant change or significant new matter or significant inaccuracy in the Prospectus … which arises between the time when the Prospectus is published and the time of Admission shall be dealt with in accordance with Regulation 10 of the POS Regulations and the AIM Rules and, in particular, should the need arise, and in consultation with the Nomad, a supplementary prospectus will be published … Each of the Directors undertakes forthwith to bring to the notice of the Company and the Nomad any such significant change, significant new matter or significant inaccuracy of which he is, or becomes, aware."

Tuesday 12 February 2002 – the final prospectus

122. On Tuesday 12 February 2002 the final version of the Cyprotex Prospectus was prepared and was received at Companies House on 13 February 2002. It was then expected that the admission would be effective, and that dealings in the ordinary shares would commence, on Friday 15 February 2002. After admission (on 15 February 2002) it was expected that the same number of shares (160,000,000) would be authorised and that 90,413,793 (£90,413.79) would be issued and fully paid. The prospectus set out the placing statistics as:

Placing price	29p
Number of placing shares	22,413,793
Net proceeds of the placing	c.£5.5 million
Number of ordinary shares in issue following the placing and admission	90,413,793
Approximate market capitalisation of the company and the placing price	£26.2 million
Percentage of the enlarged ordinary share capital represented by the placing shares	24.79 per cent

123. The Prospectus also stated that the company was to issue 22,413,793 new ordinary shares at the placing price. The placing shares had been conditionally placed with "institutional and other" investors and the placing had not been underwritten. The prospectus also stated the persons, other than the directors, who would be interested, directly or indirectly, in three per cent or more of the issued share capital. The first two persons were shown as:

	As at the date of this document		*Following admission*	
	Number of Ordinary Shares	*Percentage of issued share capital*	*Number of ordinary shares*	*Percentage of issued share capital*

Paul Davidson	31,750,000	46.69	31,750,000	35.12
Dresdner Kleinwort Wasserstein Securities Limited	nil	nil	17,059,465	18.87

124. In evidence to us Mr Adams of Altium accepted that, with his present knowledge, he would not regard Dresdner Securities as an institutional investor. However, he also pointed out that the prospectus was accurate as it referred to "institutional and other investors".

125. The Prospectus also recorded that on 12 February 2002 each of the directors and Paul Davidson had undertaken not to dispose of their shares for the period of one year and had also agreed that after that year, and for a further period of twelve months, they would only dispose of their shares through a broker to the company and in an orderly manner..

126 Also on 12 February Dresdner Securities received the full amount of the shares in Cyprotex for which they had subscribed and so the contracts for differences were formally concluded and entered into the computer system on that date. Also Dresdner Securities make an electronic report to the Authority on a daily basis and we accept the evidence of Mr Henderson that the contracts for differences with City Index would have been reported. However, Dresdner Securities would not have known whether City Index were hedging one bet or aggregating a number of bets and would not have known the identity of the spread better.

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127. Also on 12 February Mr Davidson and other existing shareholders of Cyprotex entered into a relationship deed prepared by Halliwell Landau the solicitors to Altium. (Most of the signatures were affixed by Mr Long acting as attorney).

Wednesday 13 February 2002 - Mr Long is told about the bet

128. On Wednesday 13 February Mr Davidson was still in Barbados and Mr Howe met Mr Long and Mr Warburton for a pre-lunch drink. Mr Long asked Mr Howe why Dresdner had taken a substantial position in Cyprotex and had stepped in when Credo had not taken up their shares. Mr Howe explained that the placing had been achieved by a "ground-breaking" piece of stockbroking and that he had placed a spread bet on behalf of Mr Davidson which had stimulated demand, although he did not say in what way. Mr Howe informed Mr Long that the spread bet did not have to be disclosed. He also mentioned that Mr Davidson had had legal advice about the transaction which had been given a "clean bill of health". We accept the evidence of Mr Long that Mr Howe did not articulate the arrangements clearly; that it was "all anecdotal talk" and non-specific; and that no mention was made of a contract for differences or a hedge. Mr Long saw the arrangement as "underwriting".

129. Also on 13 February Mr Long agreed with Mr Howe that he (Mr Long) should have a small bet in relation to the company.. The arrangement was that Mr Long's account should be used; that Mr Howe would put up the margin; that profits and losses would be split 50-50; and that the capital would go back to Mr Howe. Mr Long thought that the bet would be in the after market and did not understand about contracts for differences and hedging.

Wednesday 13 February 2002 - the bet is booked

130. At 2.41 pm on 13 February Mr Howe spoke to Mr Tatham to "book the trade", that is to finalise the spread bet on Mr Davidson's account. The bet was on the price of 17,650,465 shares and the market price was 29p. The bet was placed to conclude on 19 March and the City Index charge was 0.6p and so the bet price was 29.6p. Thus the Cyprotex spread bet was very large at £170,594 per point at 29.6. Mr Howe then went on to say that he had Mr Long with him. Mr Howe wanted to use the sum of £8,000 standing to his credit with City Index (because he had introduced Mr Davidson) to use as the margin for a bet on £40,000 worth of Cyprotex shares to be credited to the account of Mr Long. There would be no need for another contract for differences because the £40,000 worth of shares would already be hedged by Dresdner Securities and would reduce the amount of Mr Davidson's bet.

131. In order to credit the sum of £8,000 to Mr Long's account Mr Tatham entered into the computer a manufactured sale and purchase of some shares chosen at random (Eidos) giving a profit of £8,000. This was just a way of crediting the account. Mr Long's bet was recorded as taking place on 13 February 2002. We accept the evidence of Mr Long that he thought that the bet would be in the after market and not in the placing. We also accept the expert evidence of Mr Hinton that Mr Long's bet was not material for the purposes of the flotation.

132. Later on 13 February 2002 Mr Tatham emailed his colleagues (Mr Ticehurst, Mr Mansell and Mr Judge) and told them of the "very large trade" completed for Mr Davidson that day relating to the shares of Cyprotex. 13 February was thus the first day that Mr Ticehurst of City Index learnt that the spread bet was on the shares of Cyprotex; previously he had thought it related to the shares of Oystertec.

133. After the end of the trading day on 13 February 2002 City Index reported the bet to the Authority in accordance with its usual procedures. The reporting was done overnight or the following day and was electronic and related to all trades that day that had been entered into City Index's computer. Thus the Authority then knew that City Index had entered into a large spread bet with Mr Davidson in relation to the shares of Cyprotex.

Thursday 14 February 2002 - the contract notes

134 On 14 February 2002 City Index sent a contract note to Mr Davidson recording bets amounting to £179,244.65 (per point) on Cyprotex stock for March at 29.6 pence made on 13 February 2002 at 15.18 and 15.19. On the same date Dresdner Securities sent City Index a confirmation of transactions entered into on 12 February and these included the two Cyprotex trades, one for 15,404,293 shares and one for 1,655,172.

Friday 15 February 2002 - Cyprotex floated

135 On Friday 15 February 2002 a Reuters Business Briefing article announced that the London Stock Exchange had admitted 90,413,793 ordinary shares of 0.1p in Cyprotex fully paid to trading on AIM.

136. At this stage Mr Howe had told no-one, other than Mr Long, about the spread bet. However, he did tell all interested parties, including Altium, Gilbert Elliott, and the other placees that Dresdner Securities was participating in the placing and were subscribing for approximately 17 million shares and he accepted that he gave the

misleading impression that the stock was taken by Dresdner Limited as an investment and not by Dresdner Securities as a hedge to contracts for differences. In evidence which we accept Mr Howe said that certain assumptions were made and he did not endeavour to deny those assumptions. It was enormously fortuitous for him that there had been a meeting with Mr Cooke of Dresdner Limited on 23 January and that others had assumed that it was as a result of that meeting that Dresdner Securities had taken part in the placing; neither Altium nor Gilbert Elliott had chosen to question the matter further. Mr Howe said that he was happy for them to think that Dresdner Limited had taken the stock as an investment because by doing so it kept the true nature of the flotation completely hidden. His colleagues at Gilbert Elliott were "desperately conservative", "not particularly forward looking people" and "not prepared to move in the new world"; if any of them had known that he was involved with the placing of a spread bet to facilitate the flotation of Cyprotex there would have been "a little consternation" and "eyebrows would have been raised, and measures taken, to investigate the true nature of the flotation".

Sunday 17 February 2002 – Mr Davidson meets Mr Long

137. On 16 February 2002 Mr Davidson returned from holiday and spoke to Mr Long and Mr Howe. There was some dispute about events on 16 and 17 February and we deal with this further below.

Monday 18 February 2002 – the meeting in Macclesfield

138. At 08.24 am on Monday 18 February Mr Howe placed a post-flotation spread bet on behalf of Mr Davidson to "buy" 0.25 million shares in Cyprotex. The purpose of this bet was to "mop up" any shares which came onto the market after the listing to avoid an immediate drop in the share price. That bet was hedged the same day and the contract note was issued the next day (19 February 2002). Mr Tatham was not involved with this bet as he was on his way to Macclesfield.

139. Also on Monday 18 February there was a meeting at the offices of Oystertec when Mr Howe and Mr Tatham came to see Mr Davidson, Mr Long and some other directors to explain what had happened. The meeting was also attended by Mr Warburton (late of Addleshaws) among others. The meeting was told of the way in which the spread bet and the hedge had been used to assist the Cyprotex flotation. No notes of the meeting were kept. However, we accept the evidence of Mr Howe that no-one at the meeting thought that anything wrong had been done and that there was some discussion as to whether the same exercise could assist in future flotations. We accept the evidence of Mr Long that there was no secretiveness at all and those attending obviously believed that the process which had been adopted was completely legitimate. We accept the evidence of Mr Tatham that Mr Davidson led the meeting and did not appear to be unhappy with the arrangements for the spread bet. Mr Davidson made no complaint about Mr Howe at the meeting.

140. After the meeting Mr Long discussed matters with Mr Warburton and neither understood the full legal implications of what had been said. They sought advice from Mr Holmes, on the telephone and at a meeting, after which Mr Long was satisfied that the spread bet did not breach any regulatory requirements. The meeting was followed by lunch and that was followed by a visit to a wine bar. During the evening Mr Davidson arranged for the actor Mr Bill Roach to present Mr Howe with a Patek Philippe gold watch.

Tuesday 19 February 2002 – Mr Davidson meets Altium

141. On 19 February Mr Davidson asked Mr Adams of Altium to meet him that day for lunch. Mr Davidson told Mr Adams that a spread bet had been placed on Cyprotex's share price and added that Addleshaws had given a legal opinion. He also mentioned that he was in talks with (or going to talk with) the Authority about the use of spread betting in the context of floating other companies. Mr Davidson described the spread bet he had placed but Mr Adams found his explanation confusing. Mr Davidson wanted to use the same technique in subsequent company flotations. Mr Adams thought that the use of the spread bet was an irregular event and made further enquiries of the lawyers which led to meetings on 27 February 2002 and 5 March 2002.

Tuesday 19 February 2002 – Dresdner Securities seeks advice

142. Meanwhile, also on 19 February 2002, Mr Henderson of the Dresdner Securities Compliance department read for the first time the published statement of 11 February 2002 which stated that Cyprotex had placed 25% of its shares with institutional investors. Mr Henderson was of the view that Dresdner Securities would not normally regard themselves as "institutional investors" when they held the shares on their trading book as a hedge for a contract for differences. Mr Henderson thought that the term "institutional investor" implied that Dresdner Securities had subscribed for the shares for investment purposes, either on its own account or for clients. In fact the position was held on a trading book as hedge for a contract for differences and so the shares would be sold as soon as the contract for differences had been closed out and the hedge was no longer required. Also, Mr Henderson appreciated that Dresdner Securities was not investing in the economics of the shares; as the hedge to a contract for differences, the economic performance of the underlying shares was not of interest to Dresdner Securities. Mr Henderson then asked Mr Starbuck to speak to Gilbert Elliott about the matter

143 Accordingly, Mr Starbuck spoke to Mr Knight, the managing director of Gilbert Elliott, about the Cyprotex listing. Mr Starbuck said that his compliance department were concerned about the published statement which said that 25% of the issue had been placed with institutional investors. Mr Knight confirmed that the 25% included Dresdner Securities and that he was happy with that as Dresdner Securities was an institutional investor. (At that time Mr Howe had not informed anyone at Gilbert Elliott that a spread bet with a contract for differences had been used to facilitate the placing.)

144. Mr Henderson remained concerned and telephoned the Authority's market abuse helpline and sought advice. He spoke to Ms Janet Holmes, an associate with the market conduct team. This team had primary responsibility for monitoring firms under the market abuse regime. Mr Henderson said that he was not comfortable with Dresdner Securities being described in the statement of 11 February 2002 as an institutional investor when the shares had been purchased as a hedge for a contract for differences. Dresdner Securities were about to disclose its purchase of the shares to the company under section 198 of the Companies Act 1985 that day and its position would then be public, namely that it had an interest in the shares. However, that would not reveal that they were a hedge for a contract for differences.

145. Ms Holmes thanked Mr Henderson for the information and said she would think about it. She consulted her colleagues and later on the same day she called Mr Henderson and pointed out that, as Dresdner Securities was not required to disclose publicly the exact nature of its position, not making a disclosure would not be market abuse within MAR1.5.2.1 and would not be creating a false or misleading impression. Dresdner Securities had not encouraged or required Cyprotex to make the statement of 11 February 2002 and the Authority would not consider their circumstances to fit the definition of market abuse. Ms Holmes' concern centred round the use of the word "institutional investor" as that was the question she was being asked. She did not focus on the fact that Dresdner Securities had taken such a large proportion (80%) of the placing to hedge their contract for differences. At that time Ms Holmes did not know that the spread bet had been placed by Mr Davidson who was the majority shareholder in Cyprotex.

146. Later on 19 February Dresdner Securities lodged a disclosure notice under rule 3 of the rules governing the Substantial Acquisitions of Shares saying that it had acquired 17,809,465 shares in Cyprotex which was 19.697% of the total shares in issue. The disclosure was made to the London Stock Exchange from which it would be published on the regulatory news service of the London Stock Exchange.

Wednesday 20 February 2002 - Mr Davidson's margin is increased

147. City Index had reported the spread bet to the Authority on 13 February 2002 with its daily electronic report. On 20 February 2002 Mr Judge of City Index made an individual report of the spread bet to the Authority and spoke to Mr Nowell of the Authority's transaction monitoring unit. The report was made only because the size of the spread bet was extraordinarily large. Mr Judge was asked for the name of the client and said that it was Mr Davidson. At that time Mr Judge was not aware of Mr Davidson's holding of shares in Cyprotex, nor did he know about the structure of the contract for differences or the placing.

148. On 20 February there were discussions within City Index about Mr Davidson's position. Mr Davidson was about to send them £3 million in anticipation of future trades but he already had a large position in Cyprotex shares which had a maximum potential exposure for City Index of -£4.1 million. The shares were not very liquid. Also Mr Davidson was switching his Oystertec shares from a cash holding to a spread bet as a more tax efficient vehicle. It was agreed that that would require a bank guarantee. This was put to Mr Davidson who did not want to proceed on that basis. On 25 February Mr Ticehurst of City Index spoke to Mr Howe and said that the board wanted to increase the margin on the Cyprotex bet to 50% which would mean that another £1.5 million would be required from Mr Davidson. There were discussions with Mr Warburton and Mr Ticehurst spoke to Mr Davidson Ultimately an increased margin was agreed. At this stage Mr Ticehurst was unaware of the link between the spread bet and the placement.

27 February 2002 - Altium meet the lawyers

149. On 27 February 2002 Mr Adams of Altium had a meeting with Mr Warburton and Mr Holmes at the offices of Addleshaws. Mr Adams asked for a written summary of the transaction. That was not provided.

5 March 2002 – Altium has another meeting with the lawyers

150. There was another meeting on 5 March 2002 attended by Mr Holmes of Addleshaws; Mr Whatnall of Messrs Halliwell Landau (the lawyers for the placing), Mr Long and Mr Warburton. The arrangements for the spread bet were described and both Mr Holmes and Mr Whatnall expressed the view that, on reviewing the tests for market abuse, there did not appear to be a specific breach of such rules. We accept the evidence of Mr Long that his understanding of the situation was that both sides had looked at the legal position and "it was OK" and the lawyers did not see any immediate breach of the rules. More detailed information in writing was requested, especially about whether any arrangements had been in place between Dresdner Securities, City Index and Mr Davidson and a full description (to be given by Mr Warburton on behalf of Mr Davidson) was requested of the actual arrangements. Mr Long recalled that the view of the meeting was that the company (Cyprotex) should be informed of the transaction and that Mr Warburton should prepare a letter, on Mr Davidson's behalf, to be addressed to the company and Altium explaining the exact nature of the spread bet. Mr Long did not see any drafts of the letter but, in evidence which we accept, thought that the letter was never finalised because the situation was overtaken by the media reports and the subsequent notices from the Authority.

7 March 2002 - Gilbert Elliott become concerned

150. On 7 March 2002 Mr Knight of Gilbert Elliott telephoned Mr Cooke of Dresdner Limited to update him about Cyprotex because Mr Knight still thought that Mr Cooke had subscribed heavily for shares in the placing. Mr Cooke denied this and said he hadn't invested in Cyprotex at all. That came as a surprise to Mr Knight. Mr Cooke made enquiries and called Mr Knight later the same day and told him that the stock was held as a hedge for a contract for differences and so Dresdner Securities' holding was not an institutional shareholding. Gilbert Elliott then instituted an investigation into the matter.

151. On 13 March 2002 a representative of Gilbert Elliott contacted the Authority and a joint meeting was arranged. On 14 March 2002 there was a meeting at Gilbert Elliott about the Cyprotex placing after which Mr Howe was suspended pending an investigation. On 19 March 2002 there was a joint meeting within the Authority after which the matter was referred to the Authority's enforcement division. Mr Howe resigned from Gilbert Elliott pursuant to a compromise agreement in April 2002. We saw that agreement which was not generous. However, Mr Howe was eventually paid the commission of £46,500 which he had earned in respect of the Cyprotex placement and to which we accept he had a contractual entitlement.

152. Mr Nicholson first heard about the spread bet on 18 March during a brief conversation with Mr Adams of Altium.

19 March 2002 - Mr Davidson is investigated

153. On 19 March 2002 there was a Reuters Business Briefing Article which stated that investors were demanding an investigation by the Authority into how Mr Davidson had turned a £100,000 company into a £27M public group following a controversial spread bet. On the same day Cyprotex published a statement saying that £6.5 million had been raised from institutional and other investors. The article went on to say that Dresdner Securities was a significant investor in the placing but, at the time of the publication of the Prospectus, the company had had no knowledge that

that investment had been raised by spread betting. The Article also noted that Mr Davidson was not a director of the company at the relevant time.

154. On 21 March 2002 the Authority informed Mr Davidson that investigators had been appointed and a request for information was made on a voluntary basis. However, Mr Davidson was not interviewed by the Authority. On 11 April 2002 Mr Davidson's then solicitors, Messrs Norton Rose, wrote to the Authority.

June 2002 - City Index investigate

155. On 27 June 2002 City Index sent to the Authority their internal report into the spread bet placed for Mr Davidson. The report concluded that Mr Tatham had naively placed misguided reliance on other parties to identify and resolve all legal and regulatory issues and, without realising the implications, failed to place the proposed transaction under proper internal legal and compliance scrutiny. However, the report added:

> "There is no reason for us to conclude that Mr Tatham was in any way colluding with Nigel Howe and/or Mr Davidson in respect of this trade or that he intended (or even appreciated) that the trade might mislead or distort the market."

156. Mr Tatham was removed from the board of City Index on 27 June 2002 and had to give up his position as head of equity derivatives trading. His salary was reduced and he lost his right to a bonus. He continued to work for City Index (with reduced remuneration) until his resignation in October 2005. We accept the evidence of Mr Schreiber that, at the material time, City Index's compliance procedures did not address the circumstances of Mr Davidson's spread bet with Cyprotex. City Index subsequently implemented a number of changes to its written compliance procedures.

157. Mr Tatham was normally entitled to discretionary commission. The bet would have earned the desk between £25,000 and £50,000 (out of an annual total of about £4 million). In fact Mr Tatham did not receive any commission as result of the spread bet. Also, in the year ending on 31 March 2002 he received no bonus because of the disciplinary action taken against him. Thus Mr Tatham had nothing material to gain from his actions relating to the spread bet but he had much to lose.

November 2002 - Altium express their views

158. On 21 November 2002 Altium wrote to the Authority in response to some enquiries. They stated

> "Within the context of the market disclosure requirements at the time we do not believe that Mr Davidson or the spread betting company had an obligation to inform us of their transaction.
>
> We sought information about the success in placing shares from the broker, Gilbert Elliott. We were informed that, following a presentation the shares had been taken by Dresdner Kleinwort Wasserstein (DKW). We were subsequently informed by Gilbert Elliott that it was the syndication desk at DKW."

159. This view was confirmed to us by Mr Adams in oral evidence which we accept.

May 2003 – the views of the other placees

160. On 7 May 2003 the Authority wrote to each of the five firms who had taken part in the placing (other than Dresdner Securities). Each letter asked for the firm's view of the Cyprotex Prospectus dated 12 February 2002 following the disclosure on 19 March 2002 of the existence of Mr Davidson's spread bet. Each letter also asked if the firm was still holding the Cyprotex shares it had acquired in the placing and, if not, when the sale had taken place and the reason for the sale. Four of the five firms replied. Three said that they had no views about the Prospectus and the bet; the fourth did not comment. Most had sold some or all of their shares for which different reasons were given.

Cyprotex now

161. Shortly after the news of the spread bet became public, Mr Long resigned as a director of Cyprotex. Cyprotex is still trading. Its interim report and accounts for the eight months ending on 30 June 2002 referred to the flotation on AIM in February 2002 when £6.5 million had been raised. There was no mention of the investigation into the spread bet or the contract for differences. We accept the evidence of Mr Egerton that Cyprotex took advice from Altium and from their lawyers, Addleshaws, to check on the contents of the document and, as the spread bet was not fully understood at the time, it was decided not to mention it. The final report and accounts for the fourteen months ending on 31 December 2002 recorded major interest in its shares and noted that Mr Davidson still held 31,750,000 shares (35.12%) and that Dresdner Securities still held 17,809,465 shares (19.70%). There was no mention of the spread bet or the contract for differences. The annual report and accounts for 2003 recorded the persons who, at 1 January 2004, held interests in excess of 3% in the ordinary shares of the company. No mention was made of Mr Davidson or Dresdner Securities but 9.52% of the shares were then held by a company connected with City Index.

162. The price of Cyprotex shares after admission rose to 30.5p on Monday 18 February; the price stayed at about 30p for some days but dropped to 29.5p on 12 March 2002. On 19 March, when the spread bet became public, the price dropped to 25p but recovered to 30p on the following day. The shares then dropped further and by 8 April 2002 they were at 25p. They then declined until 28 April 2003 when they were less than five pence On 22 May 2003 the spread bet was closed and Mr Davidson suffered substantial losses on the bet. After that there was a recovery until February 2004 followed by a decline until, in October 2005, they were about ten pence.

163. About one year ago Cyprotex raised another £5 million.

164. No action was taken at any time by either the London Stock Exchange, or by AIM, about the placement of the Cyprotex shares.

The views of the Takeover Panel

165. The Takeover Panel is a regulatory body which administers the City Code on Takeovers and Mergers and is concerned with takeovers of companies whose shares are held by the public. The 2001-2002 report of the Takeover Panel (of which the vice-chairman of Dresdner Securities was a member) indicated that it had spent some

considerable time discussing the new market abuse regime which came into force on 1 December 2001 and mentioned the regulatory overlap between the Panel and the Authority. The Panel took no action over Cyprotex.

166. On 7 January 2005 the Code Committee of the Takeover Panel published a consultation paper about dealings in derivatives and options and later published another consultation paper about disclosure. On 5 August 2005 the Panel published its response which was that rules should require that all information material to the transaction should be disclosed by the holder of the derivative in which case the identity of the counterparty need not be disclosed.

The progress of the references

167. On 30 October 2003 Mr Davidson referred the Decision Notice to the Tribunal. The Tribunal held a hearing for directions on 22 January 2004 after which directions were released. On 18 November 2003 Mr Tatham referred the Decision Notice to the Tribunal. At that time he was advised by the solicitors for City Index. His reference was limited to two matters, namely, any reference within the Decision Notice that suggested that he acted dishonestly or without integrity and the level of the penalty. On 24 February 2004 Mr Tatham wrote to the Tribunal and asked to restrict his reference to the level of the penalty. In that letter Mr Tatham made a number of admissions but we have reached our Decision on the arguments and the evidence put to us at the hearing.

168. On 16 March 2004 the Tribunal gave directions which included a direction that the references of both Applicants be heard together and that submissions and any evidence relating to Mr Tatham's reference, being a reference as to penalty only, should be heard immediately following the hearing of Mr Davidson's reference. Revised directions were released in April and May 2004.

169. Mr Davidson's reference came on for hearing in June 2004. However, after four days of the hearing, a member of the Tribunal had an informal conversation with the Chairman of the Authority's Regulatory Decisions Committee. The Tribunal then formed the view that, in the circumstances of the case, a fair-minded and informed observer would not be able to exclude the real possibility of unconscious bias. Accordingly, the Tribunal recused itself.

170. A hearing for directions followed on 30 July 2004 when it was directed, among other things, that the re-hearing of the reference should take place from 20 September 2004 to 8 October 2004 (inclusive). However, on 10 September 2004 Mr Davidson made an application for legal assistance (under the Financial Services and Markets Tribunal (Legal Assistance) Regulations 2001 SI 2001 No. 3632). A directions hearing was held and the hearing fixed for 20 September to 8 October was vacated. Directions were also given about the progress of the application for legal assistance. On 12 October 2004 Mr Tatham applied for directions permitting him to raise additional issues. That application was heard at a directions hearing and was granted.

171. Because Mr Davidson failed to reply to the requests for information about his means, despite directions dated 18 January 2005, his application for legal assistance was formally refused on 14 March 2005. Further directions hearings of both

Applicants were held on 16 May 2005 when the Tribunal directed that the references be heard on the first available date after 10 October 2005 with a time estimate of six weeks. There was a further hearing for directions on 11 July 2005 to consider a number of applications made by both Applicants.

172. The first date for the hearing which was convenient for all the parties for a six week hearing was 18 January 2006.

Reasons for decision – four preliminary legal matters

173. Before we turn to consider each of the issues for determination in the references we express our views on four preliminary legal matters upon which argument was put to us. These were:

(1) Is market abuse a criminal charge ?
(2) What is the burden and standard of proof ?
(3) What is the role of the Tribunal ?
(4) Should we have considered an application of no case to answer?

(1) Is market abuse a criminal charge?

174. At a directions hearing on 30 July 2004 the Tribunal directed that the following issue should also be determined during the hearing of the reference, namely "whether the references before the Tribunal involves the determination of a "criminal charge" against the Applicants within the meaning of Article 6 of the Convention at Schedule 1 to the Human Rights Act 1988 and, if so, what consequences follow".

175. For Mr Tatham Dr Von Pommern-Peglow argued that the decision to impose a penalty was a criminal charge for the purposes of Article 6. For the Authority Mr Beazley argued that market abuse was not a criminal charge for the purposes of Article 6 but he went on to argue that, even if it were, it would not make any difference to the conduct of the references. Mr Beazley accepted that there had to be a fair trial and also argued that all the protections in Article 6, which were given where there was a criminal charge, were specifically provided for in the 2000 Act. Article 6 did not provide that the standard of proof had to be beyond all reasonable doubt and it did not contain any provisions about disclosure.

176 We first consider whether a penalty for market abuse is a criminal charge for the purposes of Article 6 and then go on to consider, if it is, what consequences follow.

177. Article 6 of the Convention gives the right to a fair trial. Article 6.1 relates to civil rights and obligations and provides that everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal. Article 6.2 relates to criminal offences and provides that everyone charged with a criminal offence shall be presumed innocent until proved guilty according to law. Article 6.3 defines five minimum rights which apply to everyone charged with a criminal offence. These five minimum rights are: the right to be informed promptly of the nature and cause of the accusation; the right to have adequate time and facilities for the preparation of the defence; the right to defend himself in person or through legal assistance of his own choosing, or, if he has not sufficient means to pay for legal assistance, to be given it free when the interests of justice so require; the right to

examine witnesses against him and to obtain the attendance and examination of witnesses on his behalf; and the right to an interpreter.

178 In reaching a decision on this matter we have been most assisted by the judgment of the Court of Appeal in *Han v Customs and Excise Commissioners* [2001] EWCA Civ 1040 which concerned a civil penalty for dishonest evasion of tax. The issue was whether such a civil penalty was a criminal charge for the purposes of Article 6. At [65] Potter LJ summarised the relevant jurisprudence of the Court of Human Rights at Strasbourg and identified three criteria routinely applied by that Court for the purpose of determining whether an applicant was the subject of a criminal charge

179 The first criterion is the categorisation of the allegation in domestic law. In these references the allegations are not categorised as criminal offences in domestic law. That is clear from a reading of section 127 of the 2000 Act which provides that decision notices about penalties for market abuse are referable to the Tribunal and are not within the jurisdiction of the criminal courts. However, as Potter LJ stated, that is no more than a starting point and is not decisive of the nature of the allegation. If the offence is not criminalised by the national law, the court determines whether it is none the less criminal in character for the purposes of Article 6 by proceeding to the second and third criteria, which are the nature of the offence and the severity of the penalty.

180. At [66] Potter LJ stated that, under the second criterion, the court considers whether or not, under the law concerned, the "offence" is one which applies generally to the public at large or is restricted to a specific group. If the former, then despite its "decriminalisation" by the national law, it is apt to be regarded as criminal. Further, if a punitive and deterrent (as opposed to a compensatory) penalty is attached, it is likely to be regarded as criminal in character, even in cases where the penalty is a fine rather than imprisonment.

181. In these references the provisions in sections 118 and 123 of the 2000 Act apply generally to the public at large, as is demonstrated by the fact that a penalty has been imposed on Mr Davidson who is not a regulated person. The penalty is not imposed as a disciplinary matter. Also the sizes of the penalties imposed on the Applicants are clearly of a substantial, punitive and deterrent nature rather than of a compensatory nature. .

182 For these reasons we conclude that the penalties for market abuse the subject of these references are criminal charges for the purposes of the Convention.

183. We now go on to consider what consequences follow from that finding and we start with the provisions of Article 6.2 and 6.3. It is clear from Article 6.2 that the first consequence must be that, in these references, the burden of proof lies on the Authority to prove their case. Of the other five minimum rights mentioned in Article 6.3 the most relevant in these references is the right to legal assistance. There are statutory provisions in the 2000 Act (sections 134 to 136) about the provision of legal assistance in connection with proceedings before the Tribunal but only in connection with penalties for market abuse. (This specific provision for legal assistance confirms our view that these proceedings are a criminal charge for the purposes of Article 6.) It was under those provisions that Mr Davidson was granted the right to apply for legal

assistance (although that had to be refused when he failed to reply to requests for information about his means).

184 We note that Article 6.3 does not mention the standard of proof nor does it mention the rules about disclosure. However, the rules about disclosure in rules 5(3) and 7 of the Financial Services and Markets Tribunal Rules 2001 SI 2001 No.2476 are comprehensive. As far as the standard of proof is concerned, we adopt the principles established by the Court of Appeal in *Han*, namely that, if market abuse penalty proceedings are a criminal charge for the purposes of Article 6, it by no means follows that, for other domestic purposes, they are to be treated as criminal. In particular, it is relevant that the rules of evidence are as contained in the Tribunal Rules and the imposition of the penalties could not give rise to a criminal record.

185. We conclude that a penalty for market abuse is a criminal charge for the purposes of Article 6. That means that the minimum rights in Article 6.2 and 6.3 apply. Accordingly, the burden of proof is on the Authority to prove its case and also the Applicants had the right to apply for legal assistance. However, it does not follow that the charges are to be treated for all purposes as criminal. We next consider the position about the standard of proof.

(2) What is the burden and standard of proof?

186. We have already found that, as a result of Article 6.2 of the Convention, the burden of proof in these references is on the Authority to prove its case and, for the Authority, Mr Beazley accepted the burden of proof.

187. As far as the standard of proof is concerned, Mr Beazley argued that this was the civil standard of the balance of probabilities. He relied upon *Hornal v Neuberger* [1957] 1 QB 247; *In re H and Others* [1996] AC 563; *B v Chief Constable of Avon and Somerset Constabulary* [2001] 1 WLR 340; *Napp Pharmaceutical Holdings Limited v Director General of Fair Trading* (2002) Competition Appeal Tribunal judgment of 15 January 2002; *Campbell v Hamlet* [2005] UKPC 19; and *R v Mental Health Review Tribunal* [2005] EWCA Civ 100.

188. For Mr Tatham Dr von Pommern-Peglow argued that in these references the difference between the criminal standard of proof (beyond reasonable doubt) and the civil standard of proof (the balance of probabilities) did not matter because an allegation of market abuse was a very serious allegation indeed and the level of penalties imposed was very high. He cited *Regina (McCann and Others) v Crown Court at Manchester and Another* [2002] UKHL 39 at [37] and [83] for the principle that, where serious matters were involved, the heightened civil standard was necessary and that the heightened civil standard and the criminal standard were virtually indistinguishable.

189 It seems to us that we have to answer two questions. First, is the appropriate standard of proof the criminal standard (beyond all reasonable doubt) or the civil standard (the balance of probability)? Secondly, if the correct standard is the civil standard, how should we apply that standard?

190. In reaching a view about the standard of proof we have first considered the authorities cited to us to see what principles they establish. *Hornal v Neuberger*

(1957) established the principle that, in a civil action, the standard of proof is that applicable in civil actions, namely proof on the balance of probability and not the higher standard of proof beyond all reasonable doubt. However, in all cases the degree of probability must be commensurate with the occasion and must be proportionate to the subject matter. As Denning LJ said at 258d, "the more serious the allegation the higher the degree of probability that is required". Hodson LJ said at 260f "no responsible counsel undertakes to prove a serious accusation without admitting that cogent evidence is required and judges approach serious accusations in the same way". Morris LJ at 266g referred to "the degree of probability which is commensurate with the occasion" and "a degree of probability which is proportionate to the subject-matter".

191 *In re H and Others* (1996) Lord Nicholls of Birkenhead said, at 586e, that "the more serious the allegation the less likely it is that the event occurred and hence the stronger should be the evidence before the court concludes that the allegation is established on the balance of probability". At 586g he added that that did not mean that, where a serious allegation was in issue, the standard of proof required was higher. It meant only that the inherent probability or improbability of an event was itself a matter to be taken into account when weighing the probabilities and deciding whether, on balance, the event occurred. "The more serious the allegation the more cogent is the evidence required to overcome the unlikelihood of what is alleged and thus to prove it."

192 In *B v Chief Constable of Avon and Somerset Constabulary (*2001) Lord Bingham of Cornhill at [29] stated that the jurisprudence of the European Court of Human Rights did not, even in criminal proceedings, require member states to apply what United Kingdom courts called the criminal standard of proof if the standard of proof was sufficiently strong in the eyes of domestic law to establish what has to be established. At [30] he went on to state that the civil standard of proof did not invariably mean a bare balance of probability; it was a flexible standard to be applied with greater or lesser strictness according to the seriousness of what had to be proved. At [31] he went on to say that, in a serious case, the difference between the criminal standard and the civil standard was largely illusory and could be indistinguishable. The civil standard should be applied with the strictness appropriate to the seriousness of the matters to be proved and the implications of proving them.

193 The relevant principle was nicely encapsulated in *Napp* (January 2002) at [107] as "the more serious the allegation, the more cogent should be the evidence before the court concludes that the allegation is established on the preponderance of probability".

194. In *McCann* (May 2002) at [27] Lord Steyn concluded that proceedings to obtain an anti-social behaviour order were civil proceedings under domestic law. At [37] he went on to say that the civil standard of proof and the criminal standard are virtually indistinguishable but that pragmatism dictated that the task of magistrates would be made more straightforward by ruling that in all such cases the criminal standard should apply,

195. In *Campbell v Hamlet* (April 2005) the issue was whether, in disciplinary proceedings against an Attorney-at-Law in Trinidad and Tobago, the correct standard

of proof was the criminal or civil standard. The Privy Council held at [16] that the criminal standard of proof was the correct standard to be applied in all disciplinary proceedings concerning the legal profession. .At [20] the Privy Council referred to the decision of the Divisional Court in *In Re a Solicitor* [1993] QB 69 which concerned the standard of proof to be applied by the Disciplinary Tribunal of the Law Society and where Lord Lane referred to "cases such as the present, where what is alleged is tantamount to a criminal offence, the tribunal should apply the criminal standard of proof".

196. In *R v Mental Health Review Tribunal* (December 2005) Richards LJ gave the judgment of the Court of Appeal. He reviewed the authorities and at [59] stated that "the essential point that runs through the authorities is that the civil standard of proof is flexible in its application and enables proper account to be taken of the seriousness of the allegations to be proved and of the consequences of proving them. At [62] he stated that, although there is a single civil standard of proof on the balance of probabilities, it is flexible in its application. The more serious the allegation, or the more serious the consequences if the allegation is proved, the stronger must be the evidence before a court will find the allegation proved on the balance of probabilities. At [69] Richards LJ concluded that, although there remains a distinction in principle between the civil standard and the criminal standard, the practical application of the flexible approach means that they are likely in certain contexts to produce the same or similar results. He then referred to three exceptional situations where the actual criminal standard was used in civil proceedings, namely, contempt of court, anti-social behaviour orders (as in *McCann*) and certain disciplinary contexts (as in *Campbell)*. He emphasised, however, that these are exceptions to the general rule.

197 In the light of those authorities we now turn to answer the two questions before us. First, we are of the view that, following *Chief Constable of Avon and Somerset Constabulary (*2001), although we have decided that these are criminal charges for the purposes of Article 6, there is no provision in Article 6 that the appropriate standard of proof is the criminal standard. We are of the view that the civil standard of proof is sufficiently strong to establish what has to be established in these references. Although in *McCann* the criminal standard was said to apply to civil proceedings relating to anti-social behaviour orders, and in *Campbell* it was said to apply to disciplinary proceedings against lawyers, nevertheless in *Mental Health Review Tribunal* these were regarded as exceptions to the general rule. Without authority to guide us we are reluctant to extend what the Court of Appeal regarded as exceptions We therefore conclude that the appropriate standard of proof is the civil standard (the balance of probabilities).

198. We next ask how we should apply the civil standard of proof. In the light of all the authorities we conclude that there is a single civil standard of proof on the balance of probabilities but that it is flexible in its application. The more serious the allegation, or the more serious the consequences if the allegation is proved, the stronger must be the evidence before we should find the allegation proved on the balance of probabilities.

199 We regard the allegations of market abuse, the subject of these references, as very serious allegations indeed. We also note that if the allegations are proved the consequences will be very serious also. A penalty of £750,000 imposed on Mr

Davidson, an unregulated individual, is very serious. A penalty of £100,000 imposed on Mr Tatham, together with the professional consequences, is also very serious. Accordingly, although there remains a distinction in principle between the civil standard and the criminal standard, the practical application of the flexible approach means that they are likely, in the context of these references, to produce the same or similar results.

200 We conclude that the standard of proof is the civil standard of the balance of probabilities. However, this is a very serious case and the penalties are severe. We must apply the standard of proof with the strictness appropriate to the seriousness of the matters to be proved and the implications of proving them. These are very serious allegations which will require cogent evidence to establish.

(3) What is the role of the Tribunal?

201. During the hearing we had to take a view about the role of the Tribunal. This occurred within the context of requests by the Applicants for witness summonses requiring the attendance of Mr Christopher Fitzgerald (the Chairman of the Regulatory Decisions Committee of the Authority at the time of the Decision Notice) and/or Ms Karen Lee (an investigator at the Authority) and/or Ms Gay Huey Evans (the Director of Markets and Exchanges at the Authority). .

202 In reaching a decision on these applications we referred to paragraph 11(1) of Schedule 13 of the 2000 Act which provides that we may by summons require any person to attend to give evidence or to produce any document which the Tribunal considers it necessary to examine. We also referred to rule 12 of our Rules which provides that the tribunal has a discretion to summons witnesses and also to Rule 10(1)(g) which contains the power to direct any party to file a document that the Tribunal considers is or may be relevant to the determination of the reference. We asked ourselves what evidence these witnesses could give to us that was relevant to the issues which we had to determine. Those issues were whether the Applicants had engaged in market abuse and, if so, whether their penalties were appropriate. To do that we decided that we would have to reach findings on disputed facts which occurred in mid-January to mid-February 2002 and then to apply the law to the facts we had found. None of the witnesses mentioned could help us in our findings of fact because none were involved in the events of 2002.

203 We noted that the Authority's investigatory powers are given to it by the 2000 Act and it is relevant that that Act only provides for certain decisions of the Authority to be referred to the Tribunal. Most, if not all, of those are decisions which affect individuals. The Tribunal itself is, of course, statutory and so it does not have an inherent jurisdiction; that means that the Tribunal cannot exercise any powers not mentioned in the 2000 Act. In particular, the Tribunal is not a Tribunal of Inquiry with wide-ranging investigatory powers. Rather our task is to undertake a complete re-hearing of the issues which gave rise to the disputed decisions. We have to hear the evidence before us, find the facts, apply the law to the facts as found and reach a Decision. We accept that there may, very exceptionally, be cases where those involved in an investigation might have evidence of fact relevant to a reference but in our view that had not occurred in these references.

204. For these reasons we decided not to issue the witness summonses requested.

(4) Should we have considered an application of no case to answer?

205. On Tuesday 21 February, which was Day 16 (out of 23) of the hearing, we completed hearing the evidence and arguments for the Authority. On that day we heard an application from Mr Davidson asking us to hear a submission of no case to answer. We also heard an application of Dr Von Pommern-Peglow, on behalf of Mr Tatham, that we should determine as a separate issue whether Mr Tatham had engaged in market abuse within the meaning of section 118 of the 2000 Act.

206. We decided to dismiss both of these applications. We were assisted by the decision of the Tribunal in *Timothy Edward Baldwin and WRT Investments Limited v Financial Services Authority* (January 2006) Tribunal Decision No.026. We began by referring to our Rules and noted that there are no specific rules about preliminary or separate issues or submissions of no case to answer. However, rule 19 directs us to conduct all hearings in such a manner as we consider most suitable for the clarification of the issues before us and to the just, expeditious and economical determination of the proceedings. We were of the view that that rule gave us a discretion to consider applications for preliminary or separate issues, and also gave us a discretion to hear submissions of no case to answer, if we considered it appropriate to do so. However, like all discretions, the discretion in rule 19 must be exercised judicially. Also we have to operate within the statutory framework of the Tribunal as set out in the 2000 Act and our Rules. Under section 133 of the 2000 Act one of our tasks is to decide what action the Authority ought to take. This is a public purpose and goes beyond the concern of the parties to this reference.

207. In these references our decisions on the issues depend primarily on findings of fact. We were of the view that, while it was for the Applicants to decide what evidence they wished to call, we would be materially assisted by hearing the evidence for the Applicants.

208. There were three other reasons for our decision to dismiss the applications. The first was that in these references there were two Applicants, only one of whom was legally represented and each Applicant had made a different application. In our view the way to determine the proceedings in the most expeditious and economical way was to proceed with hearing the evidence for the Applicants. The second reason was that, if we were to grant the application of Mr Davidson, and hear a submission of no case to answer, we would have great difficulty in not following the clear guidance of the Court of Appeal in *Benham Limited v Kythira Investments Limited and Another* [2003] EWCA 1794. This would have required us to put Mr Davidson to his election, that is we would have to require that he should choose not to call any evidence. Mr Davidson was not legally represented and we were not sure that he would fully understand the implications of this choice. The final reason for dismissing the applications was that we were, at the date of the applications, four and a half weeks into a six-week hearing. In our view the references would be disposed of in the most just, expeditious and economical matter if we proceeded to hear such evidence as the Applicants wished to put before us and then hear the closing arguments of all the parties so that we could then give a decision on all the issues in the references.

209. Accordingly we decided not to hear a submission of no case to answer and not to determine the separate issue.

210. In the light of those conclusions we now turn to consider each of the issues for determination in the reference.

Reasons for Decision Issue 1 –Did the Applicants engage in market abuse?

211. The first issue is whether the behaviour of Mr Davidson and/or Mr Tatham amounted to market abuse within the meaning of section 123(1) and section 118 of the 2000 Act.

212. In approaching this issue we first recall the relevant legislation. Section 118 provides:

> **"118(1) For the purposes of this Act, market abuse is behaviour, (whether by one person alone or by two or more persons jointly or in concert) –**
>
> **(a) which occurs in relation to qualifying investments traded on a market to which this section applies;**
>
> **(b) which satisfies any one or more of the conditions set out in subsection (2); and**
>
> **(c) which is likely to be regarded by a regular user of that market who is aware of the behaviour as a failure on the part of the person or persons concerned to observe the standard of behaviour reasonably expected of a person in his or their position in relation to the market.**
>
> **(2) The conditions are that - …**
>
> **(b) the behaviour is likely to give a regular user of the market a false or misleading impression as to the supply of, or demand for, or as to the price or value of, investments of the kind in question. …".**

213. Thus section 118(1) requires that three cumulative conditions have to be satisfied, namely:

- the behaviour must occur in relation to qualifying investments traded on a relevant market; and

- the behaviour must satisfy any one of the conditions in section 118(2); in these references the Authority relied upon section 118(2)(b) so this condition is that the behaviour must have been likely to give a regular user of AIM a false or misleading impression as to the demand for, or the value of, Cyprotex shares; and

- the behaviour must have been likely to be regarded by a regular user of AIM who was aware of it, as a failure on the part of the Applicants to observe the standard of behaviour reasonably expected of persons in their position in relation to the market.

214. Before considering whether these three legal conditions are satisfied we first have to decide what, in fact, was the behaviour of Mr Davidson and Mr Tatham. Thus we have identified the following questions as arising out of this issue:

(1) What in fact was the behaviour of Mr Davidson?
(2) What in fact was the behaviour of Mr Tatham ?
(3) Did the behaviour occur in relation to qualifying investments?
(4) Was there a false and misleading impression?
(50 Was there a failure to observe reasonable standards of behaviour?

(1) What in fact was the behaviour of Mr Davidson?

215. The first question, therefore, which we have to answer is what in fact was the behaviour of Mr Davidson.

216. The Authority put its arguments about the behaviour of Mr Davidson in its statement of case in the following way:

> "The behaviour amounting to market abuse consisted of or included the following:
>
> (1) arranging and entering into the spread bet referenced to Cyprotex …;
>
> (2) causing City Index to enter into the [contract for differences] with [Dresdner Securities];
>
> (3) causing [Dresdner Securities] to subscribe for, and be allocated, a sufficiently large tranche of Cyprotex shares to ensure that the minimum subscription condition to the placing was achieved;
>
> (4) ensuring that information as to the true reason for the spread bet, [the contract for differences] and acquisition by [Dresdner Securities] of a large tranche of Cyprotex shares was not disclosed to [Dresdner Securities] to those (other than Howe) involved in advising Cyprotex in relation to the placing and the flotation, to Cyprotex or its directors (other than in part to Long after the prospectus had been issued), to other placees … or to the market generally through the Prospectus or otherwise;
>
> (5) overall, acting and causing or permitting others to act so as to give the impression to Cyprotex and those advising Cyprotex (other than Howe) and the market as a whole that there was real demand for the [Dresdner Securities] stake of in excess of 18% of the total issued share of the company at the placing price from persons other than the largest shareholder, Davidson, when in truth there had been found to be and was no such demand for shares at that price."

217 The Authority argued that Mr Davidson, Mr Howe and Mr Tatham acted in agreement; that all were aware that the purpose of the spread bet was that it would be hedged by a contract for differences and that the counterparty to the contract for differences would hedge its own exposure by purchasing shares in the placing. By this means the placing would be filled. The Authority also argued that all three were aware (or agreed) that these arrangements would not be disclosed. Mr Davidson argued that he did not know about these arrangements at the time and he thought that Mr Howe was placing a bet for him in the aftermarket.

218. In considering this area of disputed fact we first state our views of the witnesses. Next we summarise the position of Mr Howe. Next we evaluate the evidence before us to see if it supports the case of the Authority or the case of Mr Davidson. Finally we reach our views. We bear in mind throughout that section 118 looks only to behaviour and not to intention.

(a) Our view of the witnesses

219. At the relevant time Mr Davidson was a competent and successful businessman and his evidence taken as a whole had the merit of consistency. His case had been set out as early as 11 April 2002 by his then solicitors and the substance of it did not change. It is also relevant that at that time he did not know that some telephone calls were taped but the taped telephone calls do not conflict with his case. Mr Davidson described himself as an "ideas man not a detail man". Having heard and seen his evidence we agree. For example, we accept his evidence that he did not read long legal documents, such as the Prospectus when Oystertec was admitted to AIM, or the terms and conditions of City Index. He would ask his lawyer to read the documents and tell him where to sign. We also accept that, at the time, Mr Davidson was a rich man with savings and investments of about £25 million and that the £10 million which he was likely to make when Cyprotex floated was not of overwhelming significance to him. In evidence which we accept he said that he was floating other companies at the same time.

220. Having heard and seen Mr Davidson give oral evidence we did have some reservations about its reliability. However, we bear in mind that he was giving oral evidence in early 2006 about events as long ago as 2001 and 2002. We consider that it is understandable that he could not recall dates and events with complete accuracy and, in our view, some confusion about such matters does not undermine his credibility. We also bear in mind that the burden of proof in the reference is on the Authority to prove their case and not on Mr Davidson to prove his.

221. Mr Howe is a colourful and entertaining character and calls himself "the Spaniard". He exudes charm and likes to surround himself with an air of mystery. He spent a great deal of his time at the City Tup which he regarded as his second office. However, despite his attractive personality, we did not find Mr Howe to be a reliable witness. He accepted that he had deliberately not informed anyone at his firm about the spread bet. He concealed the spread bet from the directors of Cyprotex and the Nomad. He made no attempt to ensure that it was disclosed before the flotation either in the Prospectus or otherwise. During evidence before us Mr Howe accepted that at least two of the statements he made under caution to the Authority had been erroneous. In evidence which we accept Mr Knight stated that Mr Howe had lied. We formed the view that, in resolving the issues of disputed fact, it would be unsafe to rely upon the oral evidence of Mr Howe unless it was corroborated by other reliable oral evidence or contemporaneous documents. Where the evidence of Mr Howe and that of Mr Davidson conflicted, we preferred the evidence of Mr Davidson. This extends to comments made by Mr Howe during the telephone calls when he said that he had spoken to Mr Davidson or that Mr Davidson was happy with progress; unless these comments were corroborated we accept that they were made but do not accept that they represented the truth. However, we do accept the evidence of Mr Howe that in January and February 2002 he knew nothing of the new market abuse regime which had come into force on 1 December 2001.

222. In reaching our view about the reliability of Mr Howe's evidence we have not accepted the suggestion of the Applicants that Mr Howe was persuaded to change his original evidence to the Authority by having his penalty reduced nor have we accepted the suggestion that the Authority sought to influence his evidence during the

days that he was giving it. Those are very serious allegations indeed and, in our view, the evidence did not support them.

223 We found Mr Tatham to be a precise witness. We formed the view that he was very focussed and efficient and concentrated on the tasks he had to do and did them well. He did not waste time on matters which were no concern of his. When speaking to Mr Howe he understandably ignored those colourful parts of Mr Howe's conversation which did not directly relate to specific spread bets. We found Mr Tatham to be a reliable and credible witness.

(b) The position of Mr Howe

224. From the facts we have found we conclude that, in the mind of Mr Howe, there was a scheme or arrangement which comprised the spread bet, the contract for differences and the purchase of shares in the placement by the counterparty of the contract for differences. The purpose of this scheme or arrangement was to facilitate the flotation of Cyprotex. We also find that Mr Howe was the pivot of this scheme. He was in charge of the placement. He arranged the spread bets and, because he controlled the placement, he sent the placing letters to Dresdner Securities. However, what we now have to decide is whether Mr Davidson was part of that scheme or arrangement.

(c) Does the evidence support the case of the Authority?

225. We therefore turn to consider the evidence before us to see if it supports the case of the Authority about Mr Davidson. We consider the following questions separately:

(i) Did Mr Davidson create the scheme or arrangement to facilitate the flotation of Cyprotex ?
(ii) What is the relevance of the first telephone call of 28 January 2002?
(iii) Why were the margin arrangements made so early?
(iv) Did Mr Davidson authorise the second bet after the Credo withdrawal?
(v) Why did Mr Davidson not appear concerned when he returned from holiday?

(i) Did Mr Davidson create the scheme ?

226. The Authority claimed that the scheme or arrangement to facilitate the flotation of Cyprotex was created by Mr Davidson but there was no evidence before us to support this view. Mr Davidson argued that he did not know enough about spread betting to have thought of the idea and we agree. We also bear in mind that Mr Davidson did not himself place spread bets but Mr Howe did and had done so for many years. On the evidence before us we are of the view that, with his lengthy experience and expertise in spread-betting, the scheme was most probably created by Mr Howe. Certainly it was not disputed that Mr Howe took all the steps necessary to implement the scheme.

227. The Authority relied upon the facts relating to the Clubhaus spread bet to support their view that, after that experience, both Mr Howe and Mr Davidson had learnt that when a spread bet relating to shares was placed with City Index, City Index was likely to hedge the bet with Dresdner Securities who would purchase the shares in their own name to hedge their exposure. We accept that Mr Howe learnt that in his

conversation of 4 January 2002 with Mr Tatham (although some of his conversations subsequent to the Clubhaus bet were still confused). However, Mr Davidson had nothing to do with placing or arranging the Clubhaus bet. The evidence of Mr Davidson was that he knew nothing about hedges and all he knew was that he could not vote the Clubhaus shares and that someone else could vote the shares against him. His case was that Mr Howe had placed the Clubhaus bet and Mr Howe was the person who knew about the hedging; he (Mr Davidson) just wanted to buy the shares so that he could vote. Mr Davidson pointed out that he had very little experience indeed of spread betting whereas Mr Howe had years of experience. We accept this evidence.

228. On the evidence before us, therefore, we conclude that Mr Davidson most probably did not create the scheme or arrangement to facilitate the flotation of Cyprotex.

(ii) What is the relevance of the first call of 28 January 2002?

229. The Authority argued that the first call, made by Mr Davidson to Mr Tatham on 28 January 2002 was evidence of Mr Davidson starting to instigate a large spread bet so that Dresdner Securities would acquire the shares which had not been taken up in the placement. The Authority contended that the reference to the need for the shares to be "covered" was a reference to the need for a hedge. At one stage Mr Tatham also thought that. However, having heard the taped conversation we do not agree. In our view that reference was to the amount of the margin required which was then answered by Mr Tatham. The whole context of this conversation concerns the provision of margin. The conversation is consistent with Mr Davidson's case that he wanted to place a bet in the aftermarket. In particular, we note that Mr Davidson asks about "buying" stock in a company "on the day it floats". Mr Davidson also says "And that so its going to be in the placing document then it would be well, it wouldn't be in the placing document". Those words are ambiguous and we agree with Mr Davidson that it appears that he did not know what he was talking about.

230. We also find that after the conversation with Mr Davidson on 28 January 2002 Mr Tatham was of the view that Mr Davidson was enquiring about a bet in the aftermarket and only learnt later from Mr Howe that the bet was to be in the placement.

231. Nothing in Mr Davidson's conversation with Mr Tatham on 28 January 2002 is consistent with the Authority's case that Mr Davidson instigated the scheme or arrangement to facilitate the flotation of Cyprotex and nothing is inconsistent with Mr Davidson's case that he wanted to place a bet in the aftermarket.

(iii) Why were the margin arrangements made so early?

232. Mr Davidson began to make the arrangements to lodge the margin for the bet with City Index on 1 February 2002. The Authority suggested that the lodging of the margin had to be done before 6 February for the scheme or arrangement to facilitate the flotation of Cyprotex to be effective whereas, if the bet were in the aftermarket, then the margin would not have had to be lodged until 15 February. Here we accept the evidence of Mr Davidson that he wished to ensure that the margin arrangements were in place before he went on holiday as it would be very difficult to deal with his bank when he was in Barbados. He intended to be in Barbados until 16 February which was after the date for the flotation. We also accept the evidence of Mr Tatham

that City Index wanted to receive the margin payment as soon as possible in case the spread bet was confirmed; if a client gave an order, City Index generally wanted to have the margin in the account before actually filling the order. The Authority also suggested that margin of £1 million was only consistent with the suggestion that the bet would be taking the unplaced shares and was not consistent with the idea of a bet in the aftermarket. However, we are unable to reach this conclusion from the evidence before us.

233. We conclude that there was nothing in the evidence of the telephone call of 1 February which supported the case of the Authority or was inconsistent with Mr Davidson's case.

(iv) Did Mr Davidson authorise the increase in the bet after the Credo withdrawal?

234. The Authority argued that both Sir Anthony Jolliffe and Mr Howe had discussions with Mr Davidson on 6 February about the dropping out of Credo and also argued that Mr Howe and Mr Davidson agreed that the spread bet should be increased so that Dresdner Securities would take further shares in the placing thus absorbing the shortfall.

235. There was a dispute about whether Sir Anthony Jolliffe, Mr Howe and/or Mr Long spoke to Mr Davidson in Barbados on 6 February 2002 at the time that Credo pulled out so that Mr Davidson could authorise the placing by Mr Howe of the increase in the spread bet. We have already found as a fact that at 12.57 pm United Kingdom time Mr Davidson in Barbados called and spoke to Mr Howe for four minutes and thirty-one seconds. Mr Howe gave evidence that that conversation was about the Credo withdrawal; Mr Davidson was of the view that that telephone call was about other matters and pointed out that he made the call, and not Mr Howe, and that by 12.57 pm the bet had already been increased. Mr Howe pointed out that the increased bet would not become firm until the placing letter had been signed by Dresdner Securities.

236. We find that Mr Howe had increased the bet before speaking to Mr Davidson and that confirmed to us that he was accustomed to acting on Mr Davidson's behalf without consulting him first. Also, the transcripts of the calls which we saw did not support the view that Mr Howe had spoken to Mr Davidson before the bet was increased. We agree that the increased bet would not become firm until the second placing letter had been signed by Dresdner Securities but, at the time, that was imminent. We have to reach our decisions on the evidence before us and we are not satisfied that in this context we should accept the evidence of Mr Howe in preference to the evidence of Mr Davidson.

237. Sir Anthony's evidence was that he also spoke to Mr Davidson on 6 February and that Mr Davidson was upset when he spoke to him. Mr Davidson accepted that Sir Anthony had spoken to him and had told him that Credo had pulled out. Mr Davidson also accepted that he had been irritated. However, this does not amount to proof that Mr Davidson authorised the increase in the bet after the withdrawal of Credo.

238 Mr Long gave evidence that he telephoned Mr Davidson in Barbados and told him that Credo had pulled out but Mr Davidson pointed out that there was no record

of any telephone call to or from Barbados until after the bet had been increased. Mr Long thought he had made a call but admitted that "it was impossible to be categoric". In the light of this evidence we are unable to conclude that Mr Long telephoned Mr Davidson before the bet had been increased.

239. We conclude that the evidence is insufficient for us to conclude that Mr Davidson authorised the increase in the bet after the withdrawal of Credo.

(v) Why was Mr Davidson not concerned when he returned from holiday?

240. The Authority argued that Mr Davidson's actions on his return from holiday were not consistent with his case that Mr Howe should have placed a spread bet in the aftermarket and not to facilitate the placing. If, as argued by Mr Davidson, Mr Davidson found when he returned from his holiday that Mr Howe had lied to him about the placing being over-subscribed, and then told him about the use of the spread bet, Mr Davidson should have been very annoyed.

241.. Mr Davidson's oral evidence about what happened on his return from holiday was confused. However, we bear in mind that his return from holiday was four years ago and so some confusion is understandable.

242. From the evidence before us we find that on Saturday 16 February Mr Davidson returned from holiday. He read his contract notes and the Prospectus and still thought that his bet was in the aftermarket. He spoke to Mr Long and was told that Mr Howe had used the spread bet to float the company. Mr Davidson then spoke to Mr Howe on the telephone and learnt how it had been done.

243. On Sunday 17 February Mr Davidson met Mr Long informally and Mr Davidson indicated that Mr Howe had placed a significant bet on his behalf with City Index based on movements in the share price of Cyprotex. Mr Long understood that Mr Davidson would stand to benefit if the share price rose above the placing price of 29 pence per share but would incur liabilities to City Index should the share price fall below the placing price of 29p per share. Mr Long was also told that City Index had chosen to hedge against losses under the bet by entering into an arrangement with Dresdner Securities whereby Dresdner Securities took up shares in the placing and was also told that the transactions had been approved by lawyers. Mr Davidson was excited and thought that this was a way of floating companies and told Mr Long that Mr Tatham and Mr Howe were coming on 18 February to explain it all.

244. We accept the evidence of Mr Davidson that he was impressed with what Mr Howe had done which had made Mr Davidson £10.5 million. Even though the matter had been done without his (Mr Davidson's) permission "it had been done and it worked."

245 There followed the meeting on Monday 18 February with Mr Howe, Mr Tatham and the directors of Cyprotex and then on 19 February Mr Davidson arranged a meeting with the Nomad, Mr Adams of Altium. In our view these meetings, especially that with Mr Adams, were not the actions of someone who was seeking to conceal a scheme or arrangement to facilitate the flotation of Cyprotex.

246. We conclude that the evidence does not support the case of the Authority that Mr Davidson either created or knew about the scheme or arrangement to facilitate the flotation of Cyprotex which was implemented by Mr Howe.

(d) Does the evidence support the case of Mr Davidson?

247. We now turn to consider the evidence to see if it supports the case of Mr Davidson that he thought that Mr Howe was placing a bet on behalf of Mr Davidson in the aftermarket. Mr Davidson strongly denied that he had any part in the scheme or arrangement to facilitate the flotation of Cyprotex. It was his case that that he thought that the placing was over-subscribed; that he wanted to place a spread bet in the after-market to take advantage of the rise which he expected in the share price after flotation; and that he knew that he could not hold more than a stated percentage of shares in Cyprotex and so took legal advice to make sure that the bet he wanted to place was in order. These arguments raised the following factual questions:

(i) Did Mr Davidson think that the placing was over-subscribed?
(ii) Did Mr Davidson want a bet in the aftermarket?
(iii) What is the relevance of the legal advice?

(i) Did Mr Davidson think that the placing was over-subscribed?

248. There was considerable dispute about events in early January 2002. Mr Davidson's evidence was that he was told by Mr Howe that the placing was going very well indeed and was over-subscribed and that Mr Howe suggested that a spread bet be placed for Mr Davidson to take advantage of the expected increase in the price of the shares after the placing. Mr Davidson also said that he authorised the spread bet but only in the aftermarket. He pointed out that Mr Howe stood to benefit from a percentage of the outcome of the bet and also that Mr Howe and his firm stood to benefit from the fees if the placing were successful. Mr Davidson also pointed out that, even if he, Mr Davidson, had created the idea of the spread bet he could not have influenced Dresdner Securities, the Nomad, the lawyers or the accountants, any or all of whom could have disclosed it. Mr Davidson noted that someone had told Mr Nicholson on 29 January that the placing had been filled and that this was before he had received the legal advice from Mr Holmes. Mr Howe's evidence was that he told Mr Davidson that the placing was not going well and that it was Mr Davidson's idea that a spread bet should be placed to facilitate the placing.

249. Initially we found it improbable that, at the end of January 2002, Mr Davidson believed that the placing was over-subscribed. However, having re-read some of the telephone calls made by Mr Howe to Mr Tatham (particularly those dated 29 January 2002 at 09.43 am and 3.14 pm and 6 February 2002 at 12.09 pm) we can understand that Mr Howe may have been over-optimistic in what he reported to Mr Davidson. We also note the optimism at the meeting held on 21 January 2002 at Addleshaws. At that time Mr Davidson thought that Credo would come in for £500,000; he could hope that Dresdner Securities would come in for something; there was the £3 million or so promised earlier and there was also the Chairman's List. Accordingly we accept that it was not improbable that Mr Davidson thought that the placing was over-subscribed. .However, in our view. this was the least satisfactory part of Mr Davidson's evidence.

(ii) Did Mr Davidson want a bet in the after market?

250. In evidence which we accept Mr Davidson told us that he wanted to buy more shares in Cyprotex but had been told by his lawyer that he could not do that. Mr Howe then told Mr Davidson that he could "buy" the shares through a spread bet. We initially found it improbable that Mr Davidson thought that there could be sufficient issued shares for a large bet in the after market to be hedged. In evidence, however, Mr Davidson pointed out that the value of shares in the placing had been reduced from £11 million to £6.5 million and he suggested that the 5 million authorised but unplaced shares would be available for this purpose.

251 We have some reservations about this part of Mr Davidson's evidence but accept that he may well at the time (January and February 2002) not have considered how the bet in the aftermarket was to be hedged. However, we accept the oral evidence of Mr Starbuck of Dresdner Securities that it would be "absolutely possible" to take out a contract for differences of this size in the aftermarket; it might not be the easiest of trades but it would come down to finding a seller of that amount of stock. It was not something that was out of the realms of possibility. Dresdner Securities had a large sales team and a large client base doing exactly that type of business, However, it is true to say that in making those comments Mr Starbuck had not given any thought to the lock-in arrangements which affected some of the Cyprotex shares. We also accept the evidence of Mr Tatham that it would have been possible to place a bet in the aftermarket and to hedge it; the most likely scenario would be that City Index would wait until the shares were trading and then look to hedge the bet.

(iii) What is the relevance of the legal advice?

252. Before we consider the relevance of the legal advice we have to resolve a factual dispute.

253 There was a dispute at the hearing about whether a manuscript note from Mr Davidson to Mr Holmes was genuine. The Authority claimed that this note was not genuine in that it had not been prepared at the time it purported to have been prepared (that is, on 28 January 2002) and also pointed out that it had been produced at a very late stage of the reference. The manuscript note produced to us read:

> "Please pass this to Rob
>
> To Rob Holmes Ref our conversation this morning
>
> From Paul Davidson
>
> Just a thought, the Spaniard [Mr Howe] has just told me that Cyprotex is done/oversubscribed. He has told me to have a big bet.
>
> - Is this insider information?
> - Can I have a bet on the day it floats?
> - Do I have to tell anyone, Cyprotex, Stock Exchange, Stockbrokers etc?
> - Will I have to make a bid for the company?
> - Do the terms and conditions allow me as the biggest shareholder to have a bet of any size?
>
> Rob, I should have read these terms and conditions but I only opened the account so that the Spaniard could earn enough cash to repay what I lent him.
>
> Do have a word with Warbers {Mr Warburton] He read them before I signed them."

254.. Mr Davidson gave evidence that, after he had made his call to Mr Tatham of 28 January, he wanted to make sure that his bet in the aftermarket was legal. Accordingly after he had seen Mr Holmes on 28 January 2002, he had sat down in the reception area at Addleshaws and had written the manuscript note which he asked the receptionist to give to Mr Holmes. He had not produced the note earlier because he had only found it when he was moving house. Ms Prys-Picard gave evidence that the manuscript note was not with the file and that she had not seen it. Mr Goodstone gave evidence that Mr Holmes had retired on 21 December 2002 but that he (Mr Goodstone) had reviewed Mr Holmes' papers. At Addleshaws there was a procedure that any item left in reception for a solicitor was entered into a register with the date and time of delivery, the identity of the sender and addressee, the name of the receptionist and the number of items. He had examined the register for the days of 28 to 30 January inclusive and could find no record of any item having been received for Mr Holmes from Mr Davidson.

255 .A decision on this matter is not critical to our decision on the issues in these references. However, on balance we incline to the view that the note was genuine. The reference to a loan to Mr Howe ties in with our previous conclusion that Mr Davidson made loans and not gifts to Mr Howe. We also found Mr Davidson's evidence about the way in which the note was handed to the receptionist to be convincing. We accept, however, that there was no evidence that the note ever reached Mr Holmes.

256. Although there may be some dispute about the provenance of the manuscript note there is no dispute at all that advice was sought and given. We recall that in January 2002 regulatory concern was centred round the Takeover Rules and the issue as to whether Mr Davidson could hold more that a stated percentage of shares. The letter of advice did not deal with the scheme or arrangement to facilitate the flotation but that is consistent with the case of Mr Davidson that what he wanted was a large bet in the aftermarket. Mr Davidson's desire to keep within the law is further reinforced by the comment made by Mr Howe on 29 January 2002 that "there's no way that Paul [Mr Davidson] wants to do anything that can be anyway deemed illegal". The Authority argued that it was odd that Mr Davidson appeared initially to be taking only general advice without any reference to his supposed spread bet relating to Cyprotex in the after market whereas Mr Davidson pointed out that he was connected with the flotation of four companies at that time and wanted general advice but that his manuscript note referred to Cyprotex.

257 The Authority also made the point that the written advice did not deal specifically with the proposed spread bet but Mr Davidson thought that the fourth assumption meant that, if he did not have an agreement about the manner with which the bet would be hedged, that meant that his bet would be in order. He also took from the advice the principle that all bets placed by City Index were on securities which were publicly traded which meant that he could have a bet on the day of flotation as any information he had would be made public on that day. Having read the advice he was quite happy for Mr Howe to place a bet in the after market.

258 The evidence before us is consistent with Mr Davidson's case that he wanted to purchase further shares in Cyprotex after the flotation but could not do so because

that might trigger a mandatory bid for the company under the Takeover Rules. He therefore decided to place a spread bet in the after market so that he would benefit if the price of the shares increased. The legal advice, such as it is, is consistent with this view. Certainly what the legal advice does not do is to discuss the use of a spread bet to facilitate the placing.

(e) Our views

259. On the evidence before us we had little hesitation in rejecting the Authority's case but we have more difficulty in fully accepting Mr Davidson's account of events. However, in these references the burden of proof is on the Authority to prove their case and not on Mr Davidson to prove his. Also the standard of proof required from the Authority is high.

260. We conclude that there is no evidence (apart from that of Mr Howe which we reject) that Mr Davidson learnt that his spread bet had been used to facilitate the placing until Mr Davidson returned from holiday on 16 February 2002. There is also no evidence (apart from that of Mr Howe) that Mr Davidson ever discussed with City Index what hedging arrangements they were to put in place nor is there any evidence that he agreed or reached such an understanding with City Index. The shares held by Dresdner Securities were at all times controlled by Dresdner Securities and not by Mr Davidson. Dresdner Securities could have decided either that it would not hedge its contract for differences with City Index or that it would hedge that contract in a way other than the holding of the shares. Similarly City Index could have closed its hedge with Dresdner Securities and decided either not to have a hedge or to have another hedge with another counterparty. There is no evidence of any conspiracy or any attempt to conceal. In any event, Mr Davidson could not possibly have prevented City Index or Dresdner Securities from making their returns to the Authority and the correct returns were in fact made by them. The concealment in this case was effected by Mr Howe who decided not to inform Gilbert Elliott, or Altium or the directors of Cyprotex of the scheme. We also bear in mind that Mr Davidson was on holiday for much of the time before the flotation.

261. We have to reach our conclusions on the basis of the evidence before us. Although we have considerable reservations about the evidence of Mr Davidson, we have to conclude, on the evidence before us, that the Authority has not discharged its burden of proving, to the requisite standard of probability, that Mr Davidson either created, or took part in, the scheme or arrangement to facilitate the flotation of Cyprotex. There is also no evidence whatever, even from Mr Howe, that Mr Davidson sought to conceal any arrangements. There is, indeed, much evidence to the contrary and we are surprised that the Authority ever made the serious allegation of concealment against Mr Davidson.

(2) What in fact was the behaviour of Mr Tatham?

262 The second question arising out of the first issue in the references is what in fact was the behaviour of Mr Tatham. We consider the evidence to see if it supports the case of the Authority and look at the following questions separately:

(a) Did Mr Tatham know on 28 January 2002 about the scheme or arrangement to facilitate the flotation of Cyprotex ?

(b) When did Mr Tatham know about the scheme or arrangement ?

(c) Did Mr Tatham assist the scheme or arrangement by his many contacts with Dresdner Securities?

(d) Did Mr Tatham attempt to conceal, or fail to disclose, relevant matters?

(e) Did Mr Tatham fail to consult appropriately about compliance?

(f) Should Mr Tatham be criticised for using a manufactured trade?

(a) Did Mr Tatham know on 28 January 2002 about the scheme or arrangement?

263. Before we deal with the evidence in detail we wish to record a matter which became clear to us as we listened to the evidence, which included the taped telephone conversations as well as the oral evidence of the witnesses. This may not have been the first time that spread bets were placed in the primary market but it certainly was the first time that Mr Howe and Mr Tatham had been concerned with a spread bet placed in the primary market. What was happening was clearly innovative and we formed the view that Mr Howe was feeling his way in what was then unknown territory and found it difficult to articulate the concepts clearly. In our view the initial telephone calls were imprecise and confusing because Mr Howe did not see clearly at that time exactly where they were leading. For this reason we sympathise with Mr Tatham who found the earlier calls unclear. We also record that the early telephone calls confirm the view that the relationship between Mr Tatham and Mr Davidson was contractual only. The only conversations between the two related to the arrangements for margin.

264. The conversation of 28 January 2002 between Mr Davidson and Mr Tatham is consistent with the case of Mr Tatham that the conversation was an enquiry only, that all it did was to discuss margin requirements, that the name of Cyprotex was not mentioned, and that there was nothing clandestine about the conversation. Although Mr Davidson mentioned a placement he also mentioned the aftermarket. We accept the evidence of Mr Tatham that "it was not the clearest conversation that I have ever had with anyone" and "it was a very sort of confusing conversation for me so I would not really have perhaps thought too much about … it was not very clear to me what he was trying to do at all". We accept the evidence of Mr Tatham that he thought that the purpose of the spread bet was because Mr Davidson wanted to take a bet on the share price going up and that he, Mr Tatham, was concentrating on that fact; his focus was on the spread bet and hedging it by a contract for differences.

265. In our view the conversation on 28 January 2002 between Mr Tatham and Mr Howe was also confused about Mr Davidson's intentions. Mr Howe was not very clear but was indicating that Mr Davidson wanted a spread bet on the company but possibly if City Index needed to hedge it "there might be sort of hedging it through the placement". We accept the evidence of Mr Tatham that at that stage he was not sure what was going on – it was still very much a vague enquiry and there was no way that Mr Howe could dictate where City Index would effect their hedge and City Index could not dictate to Dresdner Securities how they hedged their exposure under the contract for differences. That was entirely a matter for Dresdner Securities although Mr Tatham accepted that, if Dresdner Securities had said that they were going to hedge their contract for differences in some other way than purchasing shares in the placement, the spread bet might not have gone ahead. It is also relevant that the name of Cyprotex was not mentioned until the following day (29 January).

266. We conclude that Mr Tatham did not know on 28 January 2002 about the scheme or arrangement to facilitate the flotation of Cyprotex and so could not have agreed at that date to participate in it.

(b) When did Mr Tatham know about the scheme or arrangement ?

267. We accept the statement of Mr Tatham in his letter to the Tribunal of 24 February 2004 that in January and February 2002 he did not appreciate that the principal purpose for the spread bet was to enable the float of Cyprotex to occur. We also accept that at that time Mr Tatham had not fully appreciated what was being proposed and he believed that he had a duty of confidentiality to Mr Davidson not to disclose any information about him to Dresdner Securities.

268. We find that at all times Mr Tatham was concentrating on the fact that Mr Davidson was having a spread bet on the price of Cyprotex shares going up; in his mind the hedging of that bet was a corollary of the bet and not the purpose of it. Mr Tatham was not used to placing letters and was unclear about the procedure but realised that if Dresdner Securities were going to subscribe for shares then they would sign the placing letter. At an early stage of the discussions Mr Tatham knew that he needed to make enquiries of City Index and of Dresdner. He had never encountered placing letters before. The only regulatory issue that appeared relevant concerned the limitation on the percentage of shares that Mr Davidson could own because of the Takeover Rules of which Mr Tatham had had some experience. The conversation of 31 January 2002 at 3.45 pm made it clear that the exact amount of the shares in the placing letter to be sent by Mr Howe to Dresdner Securities depended upon amounts to be subscribed by other placees but it is not clear to us that Mr Tatham at that stage fully appreciated all that was going on.

269. We agree that Mr Howe's conversation of 6 February 2002 was ambiguous referring as it did first to being oversubscribed and then to being £500,000 short. We accept the evidence of Mr Tatham that he realised on 6 February that the second placing letter was a way of covering the shortfall but from where he was sitting at City Index the only change was that the bet was going to be for £5 million rather then £4.5 million. Mr Tatham accepted that by 7 February he knew that the flotation depended upon Dresdner Securities returning the second placing letter and realised that the corollary of the spread bet was that the flotation would go ahead.

270. We conclude that on 6 February 2002 Mr Tatham fully understood that the spread bets were being used to facilitate the flotation of Cyprotex. However, on the evidence before us it is not possible to be certain when, before 6 February, he fully appreciated the whole arrangement.

(c) Did Mr Tatham assist the scheme by his many contacts with Dresdner Securities?

271.. The Authority argued that Mr Tatham's involvement was not confined to the usual activity of taking spread bets because he was closely involved with Dresdner Securities' acquisition of the shares for their contract for differences; also Mr Tatham did not inform Dresdner Securities that the maker of the spread bet was the majority shareholder in Cyprotex.

272. At first we also thought that Mr Tatham took an unusual amount of interest in arranging for Dresdner Securities' contract for differences to be hedged in the placing.

However, having heard his evidence and seen him as a witness we are satisfied that he was only undertaking conscientiously what he saw as his task, namely the completion of spread bets on behalf of City Index. We accept his evidence that it was normal practice that, if City Index knew where Dresdner Securities could source some stock, they (City Index) would tell them where to go but that Dresdner Securities had then to make their own arrangements to purchase the shares. We also accept the evidence of Mr Tatham that, for his large clients, he would normally try to think of solutions to any issues they might have. It was frequent practice for City Index to try and assist where they could in getting the hedge. Clients might have a position in the underlying shares or have a contract for differences with another counterparty which they wanted to switch to City Index. It was perfectly normal for City Index to be involved in the hedging process at some stage in a transaction. If a trade was on a large percentage of a company then getting a hedge would be a critical factor because City Index would not be able to accept the bet unless the hedge was in place. So quite often there was a lot to do and many conversations to be had about where the hedge was actually coming from. That was normal and the bigger the percentage of the company the more conversations might be necessary. It was not uncommon for City Index to have a very heavy involvement with the counterparty acquiring the hedge. Mr Tatham's evidence is supported by that of Mr Starbuck who stated that during the course of working day it was normal for him to speak to someone at City Index several times a day.

273. In the light of the evidence before us we find that Mr Tatham's many contacts with Dresdner Securities were part of his normal pattern of trade and were not made in order to facilitate the flotation of Cyprotex; the fact that he did not inform Dresdner Securities that the maker of the spread bet was the majority shareholder in Cyprotex was in accordance with standard procedure which was designed to ensure client confidentiality.

(d) Did Mr Tatham attempt to conceal, or fail to disclose, relevant matters?

274. We find that in all his dealings Mr Tatham was open, frank and candid. There was no evidence of any understanding or agreement between him and Mr Howe as to how he should conduct the negotiations with Dresdner Securities for the contract for differences. Neither was there any understanding or agreement that any matters should not be disclosed. All the conversations between Mr Howe and Mr Tatham were on a taped line and were recorded by City Index and Mr Tatham knew that that was happening. Mr Tatham knew that the spread bet would be disclosed to the Authority by City Index in the usual way and was, no doubt, aware that the contract for differences would be disclosed to the Authority by Dresdner Securities in the usual way. There was no attempt at all to interfere with any of these arrangements. We find that Mr Tatham was at all times, on behalf of City Index, trying to offer very good customer services to a large client and trying to be as accommodating as he could be within the rules. We accept his statement that "with the large clients you always want to try and help them as best you can; that is part of the service."

275. We accept the evidence of Mr Tatham that in telephone conversations subsequent to 28 January 2002 he had no intention to conceal anything. He referred to some of Mr Howe's comments as "classic Nigel Howe comments – he makes all these sort of clandestine comments all the way through – he comes out with these clandestine comments the whole way". In evidence which we accept Mr Tatham

stated that he wanted to see a copy of the placing letter because he had not seen one before and was happy for it to be sent openly by fax to City Index. We do not accept the Authority's contention that his statement that Dresdner Securities did not know that Mr Davidson was taking out the spread bet, and would not know it, indicated any agreement to conceal. Neither do we consider that his apparent willingness, in conversations with Mr Howe, to "turn an blind eye" to the size of Mr Davidson's holdings (which they were concerned might be caught by the Takeover Rules) necessarily implies that he would in practice have behaved improperly.

276 Once Mr Tatham was satisfied that the percentage of shares held by Mr Davidson was not an issue for the spread bet he worked on the basis that City Index did not have to make enquiries as to the motive behind a client's bet. Also, Dresdner Securities would never request information about City Index's client. We accept that Mr Tatham had no wish to conceal the facts behind the spread bet from either Dresdner Securities or from the public and are again surprised that the Authority should have suggested that he did.

277. We can understand why Mr Tatham did not consider the issue of disclosure to the market. We accept the evidence of Mr Tatham that no spread bet had ever been disclosed to the market before or after February 2002 and that, at that time, no contract for differences had been disclosed either (although those rules had since changed). He was of the view that there was no obligation on the client, or on City Index, or on the counterparty to disclose the arrangements.

278. We conclude that at no time did Mr Tatham attempt to conceal or fail to disclose relevant matters.

(e) Did Mr Tatham fail to consult appropriately about compliance?

279. Mr Tatham was criticised for not consulting his compliance department. In considering this matter we bear in mind that the market abuse regime was then only two months old and that Mr Tatham had not received any training in it from City Index. We accept his evidence that he would have made more enquiries if he had been aware of the implications of the market abuse regime. Mr Tatham did consult Mr Mansell, who was head of compliance, and who had all the information. Although Mr Mansell did ask Mr Tatham to make sure that there were no legal or regulatory concerns, Mr Mansell did not flag up the implications of the market abuse regime. Mr Tatham did spot the possibility of an issue relating to the percentage of the shares held by Mr Davidson and its impact on the Takeover Rules. He discussed matters with Mr Mansell and (rightly) concluded that the Takeover Rules would not be breached. We accept the evidence of Mr Tatham that he was in and out of Mr Mansell's office quite a few times and that he was "thinking in his head" about regulatory issues.

280. We also bear in mind that Mr Tatham was aware that Dresdner Securities, who knew that they were taking almost 80% of the placement, were undertaking extensive compliance checks and he took some comfort from the fact that Mr Davidson had taken legal advice. Mr Tatham knew that Dresdner Securities did not know who City Index's client was but we accept the evidence of Mr Tatham that it was absolutely standard practice that a hedging party would never ask the name of the person, or motives, behind a spread bet. Of course, with hindsight, perhaps Mr Tatham should have consulted more but at the time Mr Tatham did not have the benefit of hindsight.

In our view Mr Tatham did all that could be reasonably expected of him under the circumstances.

281. Mr Tatham was also criticised for not asking to see the legal advice given to Mr Davidson. We accept his explanation that such advice had been given to Mr Davidson and had nothing to do with City Index.

282. We conclude that, as far as compliance is concerned, Mr Tatham did all that could be reasonably expected of him under the circumstances.

(f) Should Mr Tatham be criticised for using a manufactured trade?

283. Mr Tatham was criticised for using a manufactured purchase and sale of Eidos shares in order to effect the crediting of £8,000 to the account of Mr Long on 13 February 2002. However, we accept the evidence of Mr Tatham that that was the quickest way of making the credit from the trading floor. The City Index report of 27 June 2002 accepted that a manufactured trade could be utilised perfectly legitimately (although it did go on to say that in that particular case the making of a payment in that way inappropriately dressed the payment as a non-taxable spread bet when it should have been treated as commission income for tax purposes.) We accept the evidence of Mr Tatham that at the time he did not appreciate that there was a tax involvement.

284. While recognising that trades are sometimes booked in this way we regard the practice as undesirable and as capable of misinterpretation. However, we do not consider that the use of the manufactured trade by Mr Tatham casts any doubt upon his integrity.

(g) Our views

285. On the evidence before us we are satisfied that Mr Tatham neither created, or took part in, a scheme or arrangement to facilitate the flotation of Cyprotex; all he did was to effect a spread bet in the normal course of his business. It is a matter of great regret that he has been so adversely affected as a result.

(3) Did the behaviour occur in relation to qualifying investments?

286. The third question raised about the first issue is whether the behaviour occurred in relation to qualifying investments traded on a market within the meaning of section 118(1)(a).

287. It was agreed that AIM was a market to which section 118 applied but the Applicants argued that the behaviour took place before the shares were traded and so, at the time of the behaviour, the shares were not traded on AIM Mr Beazley referred us to Annex 3G of MAR 1 (The Code of Market Conduct) paragraph 2 third indent which stated that any behaviour whose effect persisted until the security was traded on an exchange would be behaviour in relation to that security. The third indent of paragraph 2 continues by stating:

> "New issues by a previously unlisted issuer … will not be traded on a prescribed market ahead of the issue; however, they will fall within the scope of the regime if information which is disclosed about them before the security trades on a prescribed market, for example in a prospectus, is false or

misleading. So, if a false or misleading impression persists if and when the instrument is actually traded and thereby falls within the scope of the regime, that behaviour would fall within the scope of the regime. Market abuse may therefore be said to occur when the security trades on the prescribed market.".

288. In the present references the effect of Mr Howe's behaviour did persist until the Cyprotex shares were traded on AIM. In the light of the provisions in Annex 3G of MAR 1 we conclude that the behaviour did occur in relation to qualifying investments traded on a market within the meaning of section 118(1)(a).

(4) Was there a false or misleading impression?

289. The fourth question is whether the behaviour was likely to give a regular user of AIM a false or misleading impression as to the demand for, or the value of, Cyprotex shares within the meaning of section 118(2)(b). We recall that section 118(2)(b) defines market abuse as including "behaviour [which] is likely to give a regular user of the market a false or misleading impression as to the supply of, or demand for, or as to the price or value of, investments of the kind in question".

290. Because of our conclusions on questions (1) and (2) this question does not now, in our view, concern Mr Davidson or Mr Tatham. However, we consider it on the hypothetical basis that their behaviour was as alleged by the Authority and that was the basis upon which the question was considered by the expert witnesses. In considering this question we first summarise the relevant regulatory rules in the Code of Market Conduct and the rules of AIM; we then summarise the expert evidence which was given on the assumption that the behaviour was as alleged by the Authority; we then deal with two factual issues which arose in this context; and finally we express our views.

(a) The Code of Market Conduct

291. Section 119 of the 2000 Act provides that the Authority must prepare and issue a code giving guidance to those determining whether or not behaviour amounts to market abuse. Under the provisions of section 119 the Authority has issued the Code of Market Conduct (MAR). Section 1.5 (MAR 1.5) contains provisions dealing with a false or misleading impression.

292. Section 1.1.9 states:

> "The Code does not have the effect of modifying or extending any disclosure obligations, including under the Listing Rules, the Takeover Code and SARS or which apply in relation to any prescribed market."

293. MAR 1.5.4 sets out the elements of the test. It provides:

> "1.5.4 In order to fall within the false or misleading impressions test :
>
> (1) the behaviour must be likely to give the regular user a false or misleading impression; behaviour will amount to market abuse if the behaviour engaged in is likely to give rise to, or to give an impression of, a price or value or volume of trading which is materially false or misleading; and
>
> (2) in order to be likely, there must be a real and not fanciful likelihood that the behaviour will have such an effect, although the effect need not be more likely than not. The

behaviour may, or may be likely to, give rise to more than one effect, including the effect in question."

294. MAR 1.5.5 sets out five general factors that are to be taken into account in determining whether or not behaviour is likely to give the regular user a false or misleading impression as to the supply of, or the demand for, or the price or value of a qualifying investment. .These are:

"(1) the experience and knowledge of the users of the market in question;

(2) the structure of the market, including its reporting, notification, and transparency requirements;

(3) the legal and regulatory requirements of the market concerned and accepted market practices;

(4) the identity and position of the person responsible for the behaviour; and

(5) the extent and nature of the visibility or disclosure of the person's activity."

295. MAR 1.5.8 deals with artificial transactions and provides:

"Behaviour will constitute market abuse where:

(1) a person enters into a transaction or series of transactions in a qualifying investment… ;and

(2) the principal effect of the transaction will be, or will be likely to be, to inflate, maintain or depress the apparent supply of, or the apparent demand for, or the apparent price or value of a qualifying investment … so that a false or misleading impression is likely to be given to the regular user; and

(3) the person knows, or could reasonably be expected to know, that the principal effect of the transaction or transactions on the market will be, or will be likely to be, as set out in MAR 1.5.8(2);

unless the regular user would regard

(4) the principal rationale for the transaction in question as a legitimate commercial rationale; and

(5) the way in which the transaction is to be executed as proper."

…

296. At MAR 1.5.10 it is stated that a transaction would not necessarily be considered to have been executed in an improper way simply because the way in which it was executed did not disclose the firm's intentions or positions in the market.

297. Thus both section 118(2)(b) and MAR 1.5.4(1) refer to the regular user and MAR 1.5.5(3) refers to the legal and regulatory requirements of the market concerned and accepted market practices. We received evidence about both matters from the expert witnesses, We first describe the regulatory requirements of AIM and then summarise the conclusions of the expert witnesses.

(b) The rules of AIM

298. At the relevant time rule 3 of the AIM rules provided that the company had to produce an admission document disclosing the information specified in Schedule 2. Schedule 2 provided that the admission document had to disclose a number of matters. These included: (a) information equivalent to that which would be required by the Public Offers of Securities Regulations 1995; (e) a statement that related parties and applicable employees had agreed not to dispose of any interests in any of its AIM securities for a period of twelve months from admission; (h) the name of any person who was interested, directly or indirectly in three per cent or more of the capital together with the percentage of each person's interest; and (j) "any other factual information which it reasonably considers necessary to enable investors to form a full understanding of the matters contained in the admission document". Rule 9 provided that the company had to notify the Company Announcements Office without delay of the information required by the rules and had to take reasonable care to ensure that any information it notified was not misleading, false or deceptive. Rule 15 provided that the company had to notify the Company Announcements Office without delay of any relevant changes to any significant shareholders.

299. Rule 38 related to the maintenance of orderly markets and provided that the Exchange might suspend the trading of AIM securities where trading was not being conducted in an orderly manner; where it considered that the company had not complied with the rules; where the protection of investors so required; or where the integrity and reputation of the market had been impaired by dealings in the securities.

300. As noted above, the AIM rules referred to the Public Offers of Securities Regulations 1995. Regulation 9(1) provided that a prospectus should contain all such information as investors would reasonably require, and reasonably expect to find there, for the purpose of making an informed assessment of the assets and liabilities, financial position, profits and losses, and prospects of the issuer of the securities and the rights attaching to those securities.

(c) The expert evidence – Mr Hinton

301. Before summarising the opinions of the expert witnesses we emphasise that these opinions were based on assumed facts. Both experts had been asked to assume that the allegations of the Authority about Mr Davidson and Mr Tatham had been proved. As will appear from our answer to the first question that has not been done.

302. Mr Hinton considered the matter from the perspective of a Nomad. He did not think that there was anything wrong with the scheme or arrangement to facilitate the flotation of Cyprotex but in his view it should have been fully disclosed; thus, in principle, he was of the view that the flotation of a company on the basis of a contract for differences or a spread bet was not wrong as long as it was disclosed. Also, Mr Hinton did not think that there was anything in particular wrong with spread bets being placed on companies which were coming to the market and, in general, he was of the view that such a spread bet would not necessarily have to be disclosed. However, where, as in this case, a spread bet was taken out by a very significant shareholder that might be disclosable by the company (but not by the counterparty to the spread bet).

303. Mr Hinton accepted that there was no specific provision in either the AIM rules or in the Public Offers of Securities Regulations 1995 requiring the disclosure of

the spread bet or the contracts for differences. However, he relied upon the general requirements, and especially those in paragraph (j) of Schedule 2 of the AIM rules as, in his view, the scheme or arrangement was "any other factual information which is reasonably necessary to enable investors to form a full understanding of the matters contained in the admission document". It was the view of Mr Hinton that the spread bet and the hedging arrangements in these references should have been disclosed because of the size of the bet, because the bet was placed by the major shareholder, because he assumed that the bet was placed with the specific purpose of ensuring the success of the placing, and because the bet was likely to impact the trading of Cyprotex shares in the after market. Mr Hinton concluded that the failure to disclose the spread bet and the contract for differences to the public, and the failure to explain the true cause of the success of the placement, gave a false and misleading impression.

304. More specifically, in the view of Mr Hinton, a regular user of AIM was likely to be aware that that market was disclosure driven and the regular user would expect all matters of significance to be disclosed. A regular user would be likely to have concluded from the information available that there was an aggregate demand from placees to the extent of £6.5M as normal investor demand, whereas that was not the reality; normal investor demand was only of the order of £1.6M. Although Mr Hinton could not be sure that a regular user would have thought that none of the shares related to a hedge for a spread bet, the regular user would not have concluded that the majority of the shares were held as a hedge to a contract for differences which itself was a hedge to a spread bet by the major shareholder; the regular user would expect such a transaction to have been disclosed to the board of the company.

305. Mr Hinton was also of the view that the regular user would have formed the view that Dresdner Securities had acquired the shares as a normal institutional investment which would suggest that it intended to be a medium to long term holder. Also, given the size of the holding the regular user would be unlikely to consider that Dresdner Securities was hedging a spread bet and so would have been misled as to demand. In the absence of the spread bet the placing would not have been achieved in full or would only have been achieved in full if the price had been reduced significantly. As to value, the placing price was a strong influence on subsequent price. Without Dresdner Securities the flotation would not have proceeded at the placing price of 29 pence when normal investor demand was only at £1.6 million. Mr Hinton was therefore of the view that the assumed behaviour crested an artificially high impression of the value of the shares. Further, because the placing was achieved in full, regular users would have believed that there was a desire from investors to buy shares in the aftermarket and that would stimulate upward demand. Had regular users been aware of the spread bet then this belief would have been undermined. Mr Hinton was also of the view that it would have been extremely difficult for Dresdner Securities to sell such a large holding after the placement.

306. It was also Mr Hinton's view that the appropriate means of disclosure was in the Prospectus which should have stated that the shares purchased by Dresdner Securities were held in order to hedge a contract for differences which itself hedged a spread bet by the major shareholder. Mr Hinton accepted that the Prospectus was the responsibility of the directors of the company and he thought that,. in this reference, Mr Howe should have disclosed all the facts to the company and also to the Nomad

and to the legal adviser. Mr Hinton was not concerned with the reference to Dresdner Securities as an institutional investor but was concerned that the bet had been taken out by the major shareholder and that was the unusual factor.

307. Mr Hinton agreed that that the rules placed the obligation to disclose on the directors and not the shareholders and so in this case the requirement to disclose was on the nominated broker or the company not on the shareholder. In this reference he assumed that Mr Davidson had disclosed the spread bet to Mr Howe and, in the absence of any agreement to conceal it, he had therefore, fully disclosed it. He took the view that Mr Tatham, being a regulated person, should have sought legal and regulatory advice and that his disclosure to Mr Howe was not sufficient although he accepted that, under the rules, an outsider like Mr Tatham had no obligation of disclosure. Mr Hinton also accepted that disclosure of the arrangements might have boosted the share price because the news that the majority shareholder was placing a large bet, and could lose a lot of money if the price of the shares fell, could lead to an increase in the share price. However, so long as the matter was disclosed the investor community could make that judgment.

308.. In cross-examination Mr Hinton accepted that he would consider Dresdner Securities as an investor, that he had never seen a Prospectus or an annual report that mentioned a spread bet or a contract for differences; and that he had never seen a Prospectus that set out the motives of an investor buying shares in a placement. He also accepted that the inclusion of Dresdner Securities in the Prospectus, in the list of holders of 3% or more of the company's shares, was not misleading; that the company actually received the funds; and that contracts for differences and spread bets were not relevant to any informed opinion of the assets, liabilities, or financial position of the company.

(d) The expert evidence – Mr Brown

309. Mr Brown's opinion was that "the creation of a spread bet backed up by a contract for differences which created a subscription into a company is a very clever novel piece of financial engineering. It was able to gear £1 million of investment into the creation of £5 million capital provision into a company." Mr Brown thought that there was nothing wrong with the largest shareholder effectively under-writing an issue through a spread bet as that was a demonstration of confidence in the business, but it should have been disclosed. Mr Brown was also of the view that the provision of capital to Cyprotex though the spread bet scheme was not itself behaviour which provided a misleading impression. However, if the existence of the spread bet was deliberately withheld from the market the result would be that a misleading impression of demand for, or the value of, Cyprotex shares was created.

310 Mr Brown also referred to the AIM rules, and in particular to Schedule 2(j), which provided that directors should disclose all factual information reasonably necessary for a potential investor to form a full understanding of the matters contained in the prospects. He was of the view that the fact that the scheme or arrangement to facilitate the flotation of Cyprotex was not disclosed in the prospectus meant that there was a false or misleading impression about the demand for the shares.

311 Mr Brown considered the change in the value of the ordinary shares in Cyprotex from the date of its incorporation to the date of flotation and concluded that

during that period the price had increased by 90 times. If Mr Davidson had subscribed directly for the £5 million worth of shares acquired by Dresdner Securities the Prospectus would have had to disclose his participation. It was relevant that the existing major shareholder had taken such a large position in the placing. In Mr Brown's view the value of any share was based on a number of factors but the placing price of a recently listed company was a strong influence on its subsequent price in the market. The placing was supposedly achieved and regular users of AIM would be likely to believe that there was a desire by investors to buy shares in the aftermarket. That desire would stimulate demand and induce upward pressure on the market price of the shares. If regular users had known about the spread bet then their belief in the desire of investors to buy shares with the resultant inducement of upward pressure would have been undermined. Regular users would expect most institutional investors who participated in a placing to take a medium to long term view of their investment and would not expect Dresdner Securities to be a likely seller of its entire holding when the spread bet was closed. A regular user would be aware of the lock-in arrangements as they affected Mr Davidson but would have been surprised to hear that Mr Davidson could have triggered the sale of 17.1 million shares (approximately 19% of the company) by closing out his spread bet. This could have flooded the market with shares, could have de-stabilised the after market and adversely impacted the share price. So a false and misleading impression was given that Mr Davidson's lock-in was more significant than it was.

312. Mr Brown also expressed the view that a possible subscriber would want to know that the largest shareholder, who held 46.69% of the company before the placement, indirectly provided 76% of the funds being raised. At the time of the flotation the AIM rules did not specifically address the issue of spread bets, probably because no-one had then contemplated the circumstance surrounding the Cyprotex flotation. The use of a spread bet together with a contract for differences resulting in the purchase of shares was "a very clever and innovative piece of financial engineering". The AIM rules did, however, require the disclosure of the name of any person who was directly or indirectly interested in 3% or more of the capital of the company and also of any other factual information necessary to enable investors to form a full understanding of the matters contained in the admission document. ("Interest" was defined and did not include any indirect interest through a spread bet.)

313. Mr Brown would have expected the existence of the spread bet and the subscription of Dresdner Securities to have been disclosed in the Prospectus by the directors of Cyprotex. He would have expected the broker to disclose the scheme to the board and the Nomad so that the indirect participation of Mr Davidson could have been disclosed. He accepted that the obligation to disclose in the Prospectus was a matter for the directors or the nominated broker or the Nomad and not for a shareholder or other person outside the company.

(e) Two factual issues

314 Before we express our views we deal with two factual arguments which were put to us about disclosure; one concerned the timing of the bets and the other concerned the question whether there had been full disclosure to Mr Long on 13 February 2002.

(i) Did the timing of the bet mean that it could not have been disclosed?

315. There was a dispute between the parties about the timing of the bet. Mr Beazley for the Authority was of the view that Dresdner Securities had the shares for its hedge on 7 February 2002 and that a binding spread bet was concluded by 6 February. The Applicants argued that the final prospectus was printed on 12 February, that the contract for differences was concluded on 12 February, that the spread bet was concluded on 13 February, and the contract notes for the spread bet were not sent until 14 February. That meant that it would not have been possible to make any disclosure of the spread bet in the Prospectus.

316. We are reluctant to express any view on the timing of the spread bet which we regard as a matter of commercial law which depends upon a proper construction of the commercial contracts between the better and City Index and between City Index and Dresdner Securities. However, on the evidence before us we incline to the view that the contract for differences was completed on 12 February, as that was the date stated by Dresdner Securities as the trade date; and that the spread bet was concluded on 13 February 2002 as that was the date stated in the contract note. We do not think that the contract for differences, or the spread bet, were concluded on 6 or 7 February 2002 because on those dates Dresdner Securities had only applied (albeit irrevocably) for shares in the placing. Although the first placing letter stated that allotment was expected to occur on 7 February that was before the Credo gap had occurred and there was no evidence that the shares were in fact allotted on 7 February. The shares would not have been allotted if the placing were not fully subscribed and they would not all have been allotted if the placing were over-subscribed. We accept the evidence of Mr Brown that the placing letters were conditional upon the shares being admitted to trading. However, Dresdner Securities were, no doubt, confident that the shares had been allotted to them on 12 February.

317. Having said that, we are of the view that the actual dates of the contract for differences and of the spread bet are not relevant because, even if the contracts were concluded as late as 12 or 13 February 2002, they could have been disclosed by an amendment to the Prospectus, if such disclosure were required. We accept the evidence of Mr Hinton that, even at that late stage, the directors could have issued an addendum to the Prospectus and sent it to AIM and that the float could have been "pulled" at any time up to the time that the shares started trading.

(ii) Was full disclosure made to Mr Long on 13 February 2002?

318. It was suggested by Mr Davidson that Mr Howe's conversation with Mr Long on Wednesday 13 February 2002 meant that the arrangements had been disclosed to Mr Long and so to the company. Having heard the evidence of Mr Long we are satisfied that the full facts and the full regulatory status of the spread bet, the contract for differences and the purchase of the shares by Dresdner Securities was not explained to him with sufficient clarity to enable him to understand fully all its implications. Also, we do not think that Mr Long fully understood at that time the implications of his own spread bet which he thought was in the after market. Accordingly, we are of the view that the conversation of Mr Howe with Mr Long did not amount to disclosure of the spread betting arrangements to Mr Long, nor did it amount to disclosure to the board of directors of Cyprotex, nor did it amount to disclosure to Cyprotex. It follows that, in our view, neither Cyprotex nor Mr Long could have been expected to ensure that the Prospectus was amended. We accept the

evidence of Mr Brown that the nominated broker (Mr Howe) (who was a paid adviser of the company) should have gone though a formal process of disclosure to the company and the Nomad. Rather than merely reacting to a question, Mr Howe should have been proactive and made a formal disclosure to the company

319. We conclude that full disclosure was not made to Mr Long on 13 February 2002 but we are also of the view that Mr Long was put on notice of something unusual and, as a director, would have an obligation to ask questions until he did understand what was happening. It will be recalled that he later had discussions with the lawyers.

320. We now return to consider whether, in the light of the expert opinion, the assumed behaviour of Mr Davidson and/or Mr Tatham was likely to give a regular user of the market a false or misleading impression as to the demand for, or the price or value of, the shares in Cyprotex.

(f) Our views

321. From the opinions of the expert witnesses we derive the following principles. First, that there was nothing intrinsically wrong with the scheme or arrangement to facilitate the flotation of Cyprotex so long as it was fully disclosed. Secondly, that disclosure should have been made in the Prospectus. Thirdly, that in general the persons responsible for ensuring disclosure were the directors of the company, or the Nomad, who should have been informed of the scheme or arrangement by the nominated broker. A shareholder or other person would have no responsibility for the Prospectus. Fourthly, that without disclosure the scheme or arrangement would have given a false or misleading impression as to the demand for, or the price or value of, the shares in Cyprotex.

322. As far as demand was concerned, the opinions of the expert witnesses were that a regular user would be likely to have concluded that there was an aggregate demand from placees to the extent of £6.5 million whereas normal investor demand was only of the order of £1.6 million. As to value, the placing price was a strong influence on subsequent price and without Dresdner Securities the flotation would not have proceeded at the placing price of 29 pence when other investor demand was only at £1.6 million.

323. The Authority argued that the false and misleading impression meant that the market did not have a proper opportunity to assess the price in the light of the true demand or value of the shares. The behaviour gave the impression that there was a genuine demand for the nearly 18% of the shares taken by Dresdner Securities and that that demand was not from Mr Davidson, the major shareholder when, in reality, it was. The transaction meant that control of Dresdner Securities' shares ultimately rested with Mr Davidson because the shares were likely to be retained by Dresdner Securities only so long as the spread bet was open. And the shares the subject of the spread bet were not protected by the lock-in arrangements which applied to Mr Davidson's other shares. There was also a false and misleading impression as to value

324. We are of the view that the scheme or arrangement instigated by Mr Howe did, in common parlance, give a false or misleading impression as to the demand for, and the price or value of, the shares in Cyprotex. As far as demand is concerned we

agree with the opinions of the experts that the impression gained from the Prospectus was that all the shares in the placement had been taken up by normal investors and that there was a genuine demand for the shares. As far as value and price are concerned again we agree that the Prospectus gave the impression that the price of 29 pence per share was correct because all the shares had been placed with investors at that price. We accept that Cyprotex benefited from the scheme or arrangement to facilitate its flotation because Cyprotex did actually receive £6.5 million in the placing but outside investors could have been misled into thinking that most of the finance had come from long term investors. However, the experts were of the view that any false or misleading impression could have been removed by full disclosure in the Prospectus.

325. At this stage we return to consider the rules which govern disclosure in the Prospectus. Prospectuses are prepared to comply with rules. There will always be information which could be of interest to one or more potential investors but which the rules do not require to be disclosed. In our view, that applied in this case because the rules did not require the disclosure either of the spread bet or the contract for differences. At the relevant time there was a long-standing absence of any requirement to disclose derivatives or the reasons for holding investments. Mr Hinton said that he had never seen a Prospectus or an annual report that mentioned a spread bet or a contract for differences and that he had never seen a Prospectus that set out the motives of an investor buying shares in a placement. MAR 1.1.9 provides that the Code of Market Conduct does not have the effect of modifying or extending any disclosure obligations which apply in relation to any prescribed market. In our view the wording of Schedule 2(j) of the AIM rules was not wide enough to override the established market practice and to require disclosure of the whole position. The regular user of the market would have, or ought to have, known that there could be many reasons for shares to be taken in a placing and that there was no guarantee of how long shares would be held.

326. The Authority agreed that the contract for differences was not disclosable by Dresdner Securities in the Prospectus and we can see no reason why the spread bet should be different. It was obvious to Dresdner Securities that the placing was contingent on the shares taken by them and that they were taking the shares to hedge one or more large spread bets. The fact that the spread better was a shareholder, or even the largest shareholder, is not, in our view sufficiently important to make disclosable an arrangement that is not otherwise disclosable. The shareholder is demonstrating confidence in the company and incurs the same economic risk as any other investor. If an investor knew only of the contract for differences then in our view it is unlikely that his decision to invest would be different if he also knew that the contract for differences was a hedge against a bet by the majority shareholder. Also, the fact that the majority shareholder could procure the sale of the hedged shares (but not of his own which were locked-in) would be unlikely to influence an investor because a forced sale of the hedged shares would depress the price of the much larger holding of locked-in shares.

327. We are, therefore, of the view that there was no regulatory obligation to disclose the spread bet or the contract for differences in the Prospectus and so any failure to disclose was not market abuse within the meaning of section 118 of the 2000 Act. In this respect we differ from the views of the expert witnesses but we

regard this as a matter of law which depends upon a construction of the AIM rules and of the Code of Market Conduct. We note that our view appears to have been shared by the lawyers for the company and for the placing, the Nomad, and by the other regulatory authorities (the London Stock Exchange, AIM and the Takeover Panel) none of whom took any action in this matter. We would add that Mr Beazley, for the Authority, argued that the test for market abuse could be met even if the AIM rules did not require any disclosure. We do not accept this as to do so would negate the protection afforded by section 1.1.9 of the Code of Market Conduct.

328. However, in case we are wrong in that conclusion, we have gone on to consider the position of the Applicants if there were an obligation to disclose the spread bet or the contract for differences in the Prospectus. Here we would have to proceed on the agreed basis that there was no obligation to disclose on Dresdner Securities. If the scheme or arrangement to facilitate the flotation of Cyprotex had to be disclosed by another person how should that have been done? The experts were agreed that any required disclosure should have been in the Prospectus and that had to be done by the directors. We accept the views of Mr Hinton that Mr Davidson, as a shareholder, was not entitled to alter the Prospectus and so, on the assumed basis that he had instigated the scheme or arrangement, his obligation was to disclose it to the broker, or to the Nomad, or to the company, or to a director. Mr Brown was also of the view that, if Mr Davidson had disclosed his bet to the nominated broker, it would be the responsibility of the broker to report it to the board and so ensure disclosure in the Prospectus. We also accept the views of Mr Adams of Altium that the duty of disclosure lay with the broker and the company and this was in accordance with the rules. He did not think that any duty of disclosure lay on Mr Davidson.

329. We find that Mr Davidson fully disclosed all his information to the broker (Mr Howe) and, from the evidence before us, made no attempt to conceal it or to ensure that it was concealed, prior to the flotation. The fact is, of course, that Mr Howe chose not to inform either his firm, or the Nomad, or the company through Mr Long of what he was doing. Thus, in our view, Mr Davidson complied with his obligations of disclosure on the assumed basis that he instigated the scheme or arrangement to facilitate the flotation of Cyprotex .

330. As far as Mr Tatham was concerned, again he had no entitlement to alter the Prospectus. Also he knew that the nominated broker (Mr Howe) had all the relevant information and, in our view, was entitled to assume that Mr Howe would make any necessary disclosure. Thus, in our view, Mr Tatham also complied with his obligations of disclosure on the assumed basis that he was part of the scheme or arrangement.

(f) Conclusion

331. We conclude that, in common parlance, the scheme or arrangement to facilitate the flotation of Cyprotex was likely to give a false or misleading impression as to the demand for, and the price or value of, the ordinary shares in Cyprotex. However, we are also of the view that there was no regulatory obligation to disclose the spread bet or the contract for differences in the Prospectus and so any failure to disclose was not market abuse within the meaning of section 118 of the 2000 Act. In case we are wrong about that conclusion we have also considered the position of the Applicants if there were an obligation to disclose. On the assumed basis that Mr

Davidson and Mr Tatham were complicit in the scheme, we are of the view that they made all appropriate disclosure to the nominated broker, Mr Howe. It was the responsibility of Mr Howe to make full disclosure to the Nomad and to the board of Cyprotex so that the Prospectus could contain the appropriate information for the market. Accordingly, the behaviour of Mr Davidson and Mr Tatham did not create the false and misleading impression.

(5) Was there a failure to observe a reasonable standard of behaviour?

332. The final question arising out of the first issue is whether the behaviour of the Applicants was likely to be regarded at the time by a regular user of AIM who was aware of it as a failure on the part of the Applicants to observe the standard of behaviour reasonably expected of persons in their position in relation to the market. We recall that section 118(1)(c) provides that market abuse is "behaviour which is likely to be regarded by a regular user of that market who is aware of the behaviour as a failure on the part of the person or persons concerned to observe the standard of behaviour reasonably expected of a person in his or their position in relation to the market".

333. In view of our findings on what was in fact the behaviour of Mr Davidson and Mr Tatham we do not need to consider this question. Neither dow eneed to consider this question even if Mr Davidson and Mr Tatham were complicit in the scheme or arrangement. The reason is that the three conditions in section 118 are cumulative, and we have found that the second condition has not been met (because the behaviour of Mr Davidson and Mr Tatham did not create a false and misleading impression). However, as arguments were put to us we very briefly express our views and we begin with the opinions of the expert witnesses.

(a) The views of the expert witnesses

334. Mr Hinton took into account Mr Davidson's background. Mr Davidson had completed the placing of Oystertec and was a large shareholder in Cyprotex. He was an experienced businessman who knew about flotations and of the need for full disclosure. He should have known about the role of the Nomad and the importance of the admission document (the Prospectus). Through the lock-in process Mr Davidson was an important participant in the flotation process. He should have been full and frank with the Nomad so that the Nomad could assess the disclosure requirements. He should also have disclosed matters to the directors as they would have had an obligation to disclose.

335. As far as Mr Tatham was concerned, Mr Hinton was of the view that a regular user of AIM would expect Mr Tatham to have a reasonable awareness of the rules and practices of operating in financial markets and the purpose and general processes involved in a flotation. He would be expected to be full and frank in discussions internally with City Index and to disclose details of unusual transactions to his superiors, compliance department, external lawyers or the Authority. He concluded that Mr Tatham was likely to be regarded by a regular user of AIM of failing to observe a reasonable standard of behaviour.

336. Mr Brown bore in mind that Mr Davidson had been a director of a company listed on AIM (Oystertec) and so he should have been aware of the rules of disclosure of all matters of interest to a potential investor and so should have ensured that the

directors of Cyprotex and/or the Nomad had known of the spread bet and that it would have been required to be disclosed. The regular user of the market would expect Mr Davidson or Mr Howe to have informed the board or the Nomad of the scale and unusual nature of the spread bet. If Mr Davidson conspired or worked with others to withhold the information from the market then that behaviour would be below the standard expected of a person in his position.

337. Mr Brown expressed no separate views about Mr Tatham

(b) Our views

338 This question would only be relevant if we had agreed with the Authority that Mr Davidson and Mr Tatham had been complicit in the scheme or arrangement to facilitate the flotation of Cyprotex and if we had also found that their behaviour created a false and misleading impression and constituted market abuse.

339. We would have borne in mind that Mr Davidson was not an approved person and did not read rules and regulations. He relied upon his professional advisers, and their compliance departments. In our view he would have been entitled to rely on the fact that Gilbert Elliott were being paid by Cyprotex to act as the nominated broker in the flotation and that Mr Howe of Gilbert Elliott knew all there was to know about the scheme or arrangement. Mr Howe was an approved person and, in our view, even if Mr Davidson were complicit in the scheme or arrangement, he should have been told by Mr Howe of the need for disclosure. There is no evidence that Mr Davidson concealed any of his actions.

340. We would also have borne in mind that Mr Tatham was only interested in completing the bet and securing a hedge. Mr Tatham did not know what was in the mind of Mr Howe and he was not told the full story. Indeed, Mr Howe was misleading Mr Tatham, telling him at different times that Mr Davidson had 35%, then 50% then 20% of the shares and saying first that the placement was over-subscribed and then that it was under-subscribed.

341. We have already decided that the two Applicants did not engage in the scheme or arrangement for the flotation of Cyprotex and we have also already decided that their behaviour did not create a false or misleading impression and so did not amount to market abuse. We do not therefore need to go on to decide whether they failed to observe the standards of behaviour reasonably expected of them However, if we had had to consider that we would have concluded that they did not so fail. Mr Davidson was not an approved person and, although he was experienced in flotations, nevertheless in our view, he was entitled to rely upon the professional advisers, including the nominated broker, who were being paid by Cyprotex to manage the flotation. Mr Tatham was an approved person but his only obligation would have been to ensure the disclosure of the scheme or arrangement and that could only have been done in practice through the nominated broker (Mr Howe).

Conclusion about issue (1)

342. Our conclusion on the first issue in the references is that the Applicants did not engage in market abuse. As far as Mr Davidson is concerned we conclude that, on the evidence before us, the Authority has not discharged the burden of proving to us, to the requisite degree of probability, that Mr Davidson either created, or took part in,

the scheme or arrangement to facilitate the flotation of Cyprotex. As far as Mr Tatham is concerned, on the evidence before us we are satisfied that he neither created nor took part in the scheme or arrangement and that all he did was to effect a spread bet in the normal course of his business.

343. That conclusion means that we have to determine the references in favour of the Applicants. However, we have briefly considered the other questions arising out of this issue. We find that the behaviour did occur in relation to qualifying investments. We also conclude that, in common parlance, the scheme or arrangement to facilitate the flotation of Cyprotex was likely to give a false or misleading impression as to the demand for, and the price or value of, the ordinary shares in Cyprotex. However, we are also of the view that there was no regulatory obligation to disclose the spread bet or the contract for differences in the Prospectus and so any failure to disclose was not market abuse within the meaning of section 118 of the 2000 Act. In case we are wrong about that conclusion we have also considered the position of the Applicants if there were an obligation to disclose. On the assumed basis that Mr Davidson and Mr Tatham were complicit in the scheme, we are of the view that they made all appropriate disclosure to the nominated broker, Mr Howe. It was the responsibility of Mr Howe to make full disclosure to the Nomad and to the board of Cyprotex so that the Prospectus could contain the appropriate information for the market. Accordingly, the behaviour of Mr Davidson and Mr Tatham did not create the false and misleading impression. We also conclude that Mr Davidson and Mr Tatham did not fail to observe the standards of behaviour reasonably expected of them.

Issue 2 – Should a penalty have been imposed?

344. The second issue in the references is whether a penalty should have been imposed under section 123. We remind ourselves of the provisions of section 123 which are:

> **"123(1) If the Authority is satisfied that a person "A"-**
> **(a) is or has engaged in market abuse, or**
> **(b) by taking or refraining from taking any action has required or encouraged another person to engage in behaviour which, if engaged in by A, would amount to market abuse,**
> **it may impose on him a penalty of such amount as it considers appropriate.**
>
> **(2) But the Authority may not impose a penalty on a person if, having considered any representations made to it in response to a warning notice, there are reasonable grounds for it to be satisfied that –**
> **(a) he believed, on reasonable grounds, that his behaviour did not fall within paragraph (a) or (b) of subsection (1), or**
> **(b) he took all reasonable precautions and exercised all due diligence to avoid behaving in a way which fell within paragraph (a) or (b) of that subsection.**
>
> **(3) If the Authority is entitled to impose a penalty on a person under this section it may, instead of imposing a penalty on him, publish a statement to the effect that he has engaged in market abuse."**

345. Thus three separate questions arise from this section, namely:

(1) did either or both of the Applicants, by taking or refraining from taking any action, require or encourage another person to engage in behaviour which,

if engaged in by them, would amount to market abuse within the meaning of section 123(1)(b) ?

(2) are there reasonable grounds for being satisfied that the Applicants believed that their behaviour was not market abuse or requiring or encouraging another to engage in market abuse within the meaning of section 123(2)(a); and

(3) are there reasonable grounds for being satisfied that the Applicants took all reasonable precautions and exercised all due diligence to avoid behaving in a way which amounted to market abuse or requiring or encouraging another to engage in market abuse within the meaning of section 123(2)(b)?

346. From the facts and findings we have already made we answer the first question in the negative and the second and third questions in the affirmative.

Issue 3 - Were the penalties appropriate?

347 The third issue in the references is whether the penalties were appropriate. We consider this question on the hypothetical basis that the Applicants did engage in market abuse and that the Authority were entitled under section 123 to impose a penalty.

348. In answering this question we have referred to the Authority's guidance at ENF 14.4 to 14.7 and have considered all the relevant circumstances of the case in deciding whether a financial penalty or a public statement would be more appropriate.

349. We would have regarded the alleged behaviour as serious but would not have regarded it as deliberate or reckless. The alleged behaviour only occurred once and there was little impact on the (alternative investment) market; public confidence in that market was not damaged. As a result of the behaviour Mr Davidson gained the immediate benefit of the flotation of Cyprotex but lost a considerable sum (in the region of £4.5 million) from his spread bet. As a result of his behaviour Mr Tatham lost his bonus and his position as executive director, and ultimately his employment, and gained nothing. There appeared to be no loss or risk of loss caused to other market users.

350. We would also have borne in mind that almost immediately after the flotation Mr Davidson brought the matter to the attention of the board of Cyprotex and the Nomad; as he was not an approved person he then had no duty to the Authority. Mr Tatham co-operated very fully both with the investigations of the Authority and of City Index. Remedial action was not required as no action was taken by AIM. Also it is relevant that the requirements of the Takeover Panel were complied with. Another relevant factor is that the users of the AIM are sophisticated users and that the other placees in the Cyprotex flotation were mainly large investors. It does not appear that any of the other placees suffered any loss. We would also have considered action taken by the Authority in previous cases. We are not aware of any previous cases where the behaviour was the same or similar as in this case. We are also not aware of any previous case where a penalty as high as £750,000 has been imposed on an unapproved individual acting in a private capacity.

351 We would also have considered the impact that any financial penalty or public statement might have on the financial markets or on the interests of consumers. We appreciate that a penalty can show that high standards of market conduct are being enforced in the financial markets; may bolster market confidence; and may protect the interests of consumers by deterring future market abuse and improving standards of conduct in a market. However, it is most unlikely that the same type of behaviour will happen again and the rules have been changed to ensure that a contract for differences is disclosed. We would also have had in mind the disciplinary record and general compliance history of the Applicants including the fact that the Authority has not taken any previous action against the Applicants and that the conduct of the Applicants has not caused concern to any other regulatory authority or been the subject of a warning or other action by a regulatory authority;

352. Finally we would have borne in mind that the market abuse provisions had only been in force for two months at the relevant time and that no specific guidance had been issued on the behaviour in question. In our view there were no disclosure obligations at the relevant time and even the experts were not aware of any previous disclosure of a spread bet or a contract for differences in a Prospectus. It is also relevant that Mr Tatham was acting for a legitimate purpose and in a proper way,

353. In the light of all those factors we would have concluded that the appropriate penalty, on the basis that the Applicants had engaged in market abuse, would have been a published statement under section 123(3) to the effect that the Applicants had engaged in market abuse.

Issue (4) – Was Mr Tatham in breach of Principles 2 and 3?

364. The fourth issue in the references is whether Mr Tatham was in breach of Principles 2 and 3.

365. The "Statements of Principle and Code of Practice for Approved Persons" (APER) has been issued by the Authority under the provisions of section 64 of the 2000 Act. APER 4.2 states Principle 2 which is that an approved person must act with due skill, care and diligence in carrying out his controlled function. APER 4.3 states Principle 3 which is that an approved person must observe proper standards of market conduct in carrying out his controlled function.

366. On the facts which we have found we conclude that Mr Tatham did act with due skill, care and diligence, and observed proper standards of market conduct, in carrying out his controlled function

Summary of decisions on all the issues

367. In summary we conclude that the Applicants did not engage in market abuse. As far as Mr Davidson is concerned we conclude that, on the evidence before us, the Authority has not discharged the burden of proving to us, to the requisite degree of probability, that Mr Davidson either created, or took part in, the scheme or arrangement to facilitate the flotation of Cyprotex. As far as Mr Tatham is concerned, on the evidence before us we are satisfied that he neither created nor took part in the scheme or arrangement and that all he did was to effect a spread bet in the normal course of his business. Neither Applicant sought to conceal any of their actions.

368. That conclusion means that we have to determine the references in favour of the Applicants. However, we have very briefly considered the other questions arising out of issue (1) and we find: that the behaviour did occur in relation to qualifying investments. We also conclude that, in common parlance, the scheme or arrangement to facilitate the flotation of Cyprotex was likely to give a false or misleading impression as to the demand for, and the price or value of, the ordinary shares in Cyprotex. However, we are also of the view that there was no regulatory obligation to disclose the spread bet or the contract for differences in the Prospectus and so any failure to disclose was not market abuse within the meaning of section 118 of the 2000 Act. In case we are wrong about that conclusion we have also considered the position of the Applicants if there were an obligation to disclose. On the assumed basis that Mr Davidson and Mr Tatham were complicit in the scheme, we are of the view that they made all appropriate disclosure to the nominated broker, Mr Howe. We also conclude that Mr Davidson and Mr Tatham did not fail to observe the standards of behaviour reasonably expected of them.

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369 We do not need to consider issues (2), (3) and (4) but as arguments were put to us we very briefly express our views. On the subject of issue (2) (whether a penalty should have been imposed), and assuming that the Applicants did engage in market abuse, we conclude that neither of the Applicants, by taking or refraining from taking any action, required or encouraged another person to engage in behaviour which, if engaged in by them, would amount to market abuse; that there were reasonable grounds for being satisfied that the Applicants believed that their behaviour was not market abuse or requiring or encouraging another to engage in market abuse; and that there were reasonable grounds for being satisfied that the Applicants took all reasonable precautions and exercised all due diligence to avoid behaving in a way which amounted to market abuse or requiring or encouraging another to engage in market abuse. Accordingly, we would not have imposed a penalty even if the Applicants had engaged in market abuse.

370. We also briefly considered issue (3) (whether the penalties were appropriate) on the two assumptions that the Applicants had engaged in market abuse and that a penalty should have been imposed. Here we concluded that, having regard to all the relevant circumstances, we would, instead of imposing financial penalties, have published a statement to the effect that the Applicants had engaged in market abuse.

371. Finally, on the subject of issue (4) (whether Mr Tatham had been in breach of Principles 2 and 3) we find that Mr Tatham was not in breach of those principles.

Decision

372. Our unanimous decision is that these references have to be determined in favour of the Applicants.

373. Section 133(4) and (5) of the 2000 Act provide that on a reference the Tribunal must determine what, if any, is the appropriate action for the Authority to take in relation to the matter referred to the Tribunal and that, on determining a reference, the Tribunal must remit the matter to the Authority with such directions (if any) as the Tribunal considers appropriate for giving effect to its determination.

Section 133(8) provides that, on determining a reference, the Tribunal may make recommendations as to the Authority's procedures.

374 WE THEREFORE REMIT the matter to the Authority AND DIRECT that the Authority must not take the action specified in the Decision Notice as far as the two Applicants are concerned.

DR A N BRICE

CHAIRMAN

RELEASE DATE:

FiIN/2003/0016
FIN/2003/0021
16.05.06