COSTS – whether the disputed decision of the Authority was unreasonable – yes – whether the Authority acted vexatiously, frivolously or unreasonably in connection with the proceedings – no – FSMA 2000 Sch 13 para 13(1) and (2)

THE FINANCIAL SERVICES AND MARKETS TRIBUNAL

PAUL DAVIDSON

First Applicant

ASHLEY TATHAM

Second Applicant

- and -

THE FINANCIAL SERVICES AUTHORITY

Respondent

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

Sitting in London on 7 September 2006

The First Applicant in person

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

Javan Herberg of Counsel, instructed by the Financial Services Authority, for the Authority

DECISION

The applications

1. On 19 June 2006 Mr Paul Davidson (Mr Davidson) and Mr Ashley Tatham (Mr Tatham) each applied for a costs order against the Financial Services Authority (the Authority). Each sought an order that the Authority should pay the costs incurred by him in connection with his proceedings before the Tribunal. Each had previously referred to the Tribunal a decision notice issued by the Authority on 23 October 2003 and the Tribunal had determined the proceedings in their favour.

The legislation

2. The legislation which governs the award of costs by the Tribunal is found in paragraph 13 of Schedule 13 of the Financial Services and Markets Act 2000 (the 2000 Act) and in Rule 21 of the Financial Services and Markets Tribunal Rules 2001 SI 2001 No 2476 (the Rules).

3. Paragraph 13 of Schedule 13 of the 2000 Act provides:

> **"13(1) If the Tribunal considers that a party to any proceedings on a reference has acted vexatiously, frivolously or unreasonably it may order that party to pay to another party to the proceedings the whole or part of the costs or expenses incurred by the other party in connection with the proceedings.**
>
> **(2) If, in any proceedings on a reference, the Tribunal considers that a decision of the Authority which is the subject of the reference was unreasonable it may order the Authority to pay to another party to the proceedings the whole or part of the costs or expenses incurred by the other party in connection with the proceedings."**

4. Rule 21(3) provides that where the Tribunal makes a costs order it may either (a) fix the amount or (b) direct that the costs should be assessed on such basis as it should specify by a costs official (of the Court).

The directions

5. On 11 July 2006 a directions hearing was held when it was directed:

> (1) that the applications for costs orders be considered at a hearing to take place as soon as possible …
>
> (2) that the matters to be considered at the hearing are:
>
> (a) whether the Tribunal considers that the decisions of the Authority which were the subject of the references were unreasonable within the meaning of paragraph 13(2) of Schedule 13 of … the 2000 Act; or
>
> (b) whether the Tribunal considers that the Authority acted vexatiously, frivolously or unreasonably in connection with the proceedings within the meaning of paragraph 13(1) of Schedule 13 of the 2000 Act;

(3) that if either question is answered in favour of one or both Applicants then the amount fixed by the Tribunal under Rule 21(3)(a) … or, alternatively, a decision whether the costs should be assessed by a costs official under Rule 21(3)(b), shall be determined at a later date. …

(5) that by consent no oral evidence shall be admitted at the hearing mentioned in Direction (1)".

6. The hearing of the applications for costs orders was held on 7 September 2006 and was restricted to the matters mentioned in Direction (2).

The documents

7. Four bundles of documents were produced at the hearing. One bundle contained the documents which were before the Authority's Regulatory Decisions Committee when they took the decisions which were the subject of the references. These documents had not been before the Tribunal previously.

The facts

8. In finding the facts relevant to these applications we first describe the process of decision-making by the Authority and the review of that process which was carried out in 2005. We then consider in some detail the way in which the Authority's Regulatory Decisions Committee, in a series of five separate meetings, made the decision to issue the decision notice which was referred to us. We finally summarise our own findings and decision on the references.

The Authority's process of decision-making

9. Section 1 of the 2000 Act gives the Authority all the functions conferred on it by or under the Act. The Authority is a company limited by guarantee not having a share capital. Article 24 of its Articles of Association provides that it shall have a Governing Body or Board. The Chairman and the members of the Board are appointed by the Treasury.

10. The way in which some decisions are to be taken by the Authority is also regulated by the 2000 Act. Relevant to these references is Part XXVI (sections 387 to 396) which deals with notices. Briefly, the provisions are that the Authority must first give a warning notice stating the action which it proposes to take and inviting representations; later it may give a decision notice which may be referred to the Tribunal; if the decision notice is not referred to the Tribunal, the Authority may then give a final notice.

11. Section 395 contains provisions about the Authority's procedures in relation to warning notices and decision notices. Section 395(1) provides that the Authority must determine the procedure that it proposes to follow in relation to the giving of warning notices and decision notices and section 395(2) provides that the procedure must be designed to secure, among other things, that the decision which gives rise to the obligation to give any such notice is taken by a person not directly involved in establishing the evidence on which that decision is based.

12. In order to comply with the requirements of section 395(1) the Authority sets out its decision-making procedures in a part of its Handbook (DEC). The requirements of section 395(2) are met .by the establishment of the Regulatory Decisions Committee (the Committee). The Committee is a Committee of the Authority's Board and its members are appointed by the Board. It consists of a Chairman, one or more Deputy Chairmen and other members. Apart from the Chairman, none of the other members is an employee of the Authority and the Committee operates outside the Authority's management structure. However, the Committee takes decisions on behalf of the Authority and so the decisions are those of the Authority.

The 2005 review

13. In July 2005 the Authority published a report and recommendations following an enforcement process review. The review had been commissioned by the Authority because the enforcement process had been criticized by the Tribunal in January 2005 in *Legal and General Assurance Society Limited v Financial Services Authority* Tribunal Decision No. 011 and because "it was evident that many affected by enforcement actions had doubts about the fairness of the process". The report made forty-four recommendations. One was that, before a case was referred to the decision-makers there should be a thorough legal review by lawyers in the Authority's Enforcement Division who were not part of the investigation team. (At the time such a review was not current practice). The report also recommended the creation of a small, dedicated legal function to assist the Committee in its decision making so that the Committee would not have to look to the Enforcement Division for legal advice and support and so that confidential communications between the Enforcement Division and the Committee should cease. Yet a third recommendation was that all oral and written communications between the Enforcement Division and the Committee would be disclosed so that those subject to enforcement action would be completely clear about the case they had to meet. Another recommendation was that the practice under which the Enforcement case team had direct access to the Committee after the conclusion of the representations meeting without the firm or individual being present would end.

14. The enforcement process review was mentioned in the "Enforcement annual performance account 2005/06" published by the Authority. It stated that all forty-four of the recommendations had been accepted by the Authority's Board and that two of the key principles driving the recommendations were that there should be sufficient checks and controls during the investigation phase to help deliver balance and fairness and that there should be transparency for those subject to enforcement action about the case they had to answer and the evidence on which it was based. Mr Herberg informed us at the hearing that case review papers are now disclosed, before the hearing of the Regulatory Decisions Committee, to the persons to whom a warning notice or decision notice might be sent.

Consideration by the Committee

15. On 21 May 2003 the proposal to issue a warning notice to Mr Davidson and Mr Tatham first came before the Committee. The Committee had before them an investigation report, a case review paper, a draft warning notice and copies of responses by or on behalf of Mr Davidson and Mr Tatham.

The investigation report

16. The investigation report was signed on 12 May 2003 and it was lengthy (52 pages long). It first summarized the statutory and regulatory background by setting out the relevant provisions of the 2000 Act (but not the Code of Market Conduct) and the Principles as set out in the Handbook. It then summarized the investigation which had begun on 21 March 2002. The persons mentioned in the draft warning notice had been informed of the investigation and its scope on the same date (21 March 2002). (Mr Davidson's solicitors replied on 11 April 2002 setting out his case.) Preliminary Findings Letters were sent to Mr Davidson and Mr Tatham and others on 5 February 2003 and Mr Davidson and Mr Tatham had responded by April 2003 (although Mr Davisdson did not comment in detail). The investigators then invited voluntary co-operation from all parties in providing documents and attending interviews. Mr Tatham was interviewed but Mr Davidson declined. The Authority decided not to use its powers under section 175 of the 2000 Act to compel his attendance at interview but did use its powers under section 173 of the 2000 Act to compel his production of telephone records.

17. The investigation report continued by summarizing the facts and the evidence in detail and followed this by identifying ten issues of fact where the evidence of the witnesses and/or the documents were in conflict. Each area was considered and conclusions drawn. The report concluded that Mr Davidson and Mr Tatham, together with a Mr Nigel Howe (Mr Howe), had engaged in market abuse; that there were no reasonable grounds to be satisfied that they believed that their behaviour did not amount to market abuse or that they took all reasonable precautions and exercised all due diligence to avoid such abuse within the meaning of section 123(2) of the 2000 Act; and that Mr Howe and Mr Tatham had breached Principles 1, 2 and 3.

The case review paper

18. The case review paper was also signed on 12 May 2003. It referred to the investigation report and the draft warning notice together with the responses received from Mr Davidson and his solicitors, from Mr Howe and from Mr Tatham which were all annexed. It also referred to the Code of Market Conduct. The paper stated that this was the first market abuse case to be considered by the Committee and tried to identify for the Committee particular issues which might be raised by the recipients of the warning notice. The paper drew attention to significant conflicts of evidence between Mr Davidson and Mr Howe and accepted that the case against Mr Davidson depended in part on the evidence of Mr Howe. It stated that the Authority had interviewed Mr Howe, but not Mr Davidson, and preferred the evidence of Mr Howe. It also referred to the lack of co-operation by Mr Davidson in not being interviewed voluntarily but noted that, as he was not an approved person, he did not have any obligation to assist the Authority with their enquiries. The Authority had not interviewed Mr Davidson under compulsion to avoid any evidential difficulties in relying on such evidence in market abuse proceedings. It was accepted that Mr Howe had a pivotal role in the matter. As far as Mr Tatham was concerned the case review paper said that his lesser involvement was reflected in the penalty proposed.

19. The case review paper went on to consider whether the Authority should bring criminal proceedings but concluded that it should not. The reason was that prosecution was unlikely to result in a significant sentence because: there had been no personal financial gain to any of Mr Davidson, Mr Howe and Mr Tatham; because there was no

evidence of financial loss to any investors or potential investors; and because each of Mr Davidson, Mr Howe and Mr Tatham had themselves suffered loss. Turning to the level of the penalties the paper remarked that, as this was the first market abuse case, there were no precedents available. The paper recommended that the penalty in respect of Mr Davidson was inevitably the highest "given that he was the instigator of the scheme". The financial penalty had to reflect the fact that Mr Davidson was not an approved person and so could not be subject to a prohibition or withdrawal of approval. "If he had disclosed the spread bet it is inconceivable that the listing would have succeeded". As far as Mr Howe was concerned, his actions would not have succeeded if it had not been for his complicity with Mr Davidson. The paper continued:

> "However, we recommend that Howe should be given a significant discount primarily to reflect his co-operation with the FSA's investigation. The FSA could not bring this case without that co-operation and it is important that we incentivise individuals to provide such assistance with market abuse investigations in the future (particularly in light of the evidential hurdles and restrictions in such cases)."

The draft warning notice

20. The draft warning notice was also lengthy (30 pages) It proposed the imposition of a penalty of £500,000 on Mr Davidson; £250,000 on Mr Howe and £100,000 on Mr Tatham. The warning notice set out the relevant legislation and referred to the Code of Market Conduct and analysed the alleged behaviour of Mr Davidson, Mr Howe and Mr Tatham by reference to the statutory provisions. However, one of the relevant statutory provisions is in section 118 of the 2000 Act and is that market abuse is defined by reference to the concept of the regular user but there was no consideration given to the views of the regular user. Another relevant statutory provision is that section 123(2)(a) provides that the Authority does not have power to impose a penalty if there are reasonable grounds of for it to be satisfied that a person believed that his behaviour was not market abuse.

The first meeting on 21 May 2003

21. At their meeting on 21 May 2003 the Committee (Group A) considered the recommendation for the issue of a warning notice proposing to impose financial penalties on the three individuals. They considered the facts as presented to them in detail. They noted that Mr Howe and Mr Tatham had co-operated with the investigation and had been interviewed by the Authority but that Mr Davidson had declined to be interviewed voluntarily. They noted that there were a number of issues of fact where the evidence of witnesses, in particular, Mr Davidson and Mr Howe, conflicted. However, where such evidence conflicted it was noted that the Authority preferred that of Mr Howe. It was also noted that the Authority had recommended a lesser penalty for Mr Howe to take account of his extensive co-operation with the investigation and also that he was no longer employed. It was noted that the Authority also recommended a significantly lower penalty for Mr Tatham to recognize that the extent to which he was involved with the scheme was much less than Mr Davidson and Mr Howe. Consideration had been given to the commencement of criminal proceedings but these would only be possible against Mr Davidson and Mr Howe and in any event the levels of financial penalty were likely to be substantially lower. The Committee resolved that the warning notices should be sent but

increased the penalties for Mr Davidson and Mr Howe to £750,000 and £350,000 respectively "to reflect the seriousness of their culpability and to send a strong message to the market that such behaviour and conduct would result in a heavy penalty".

22 The warning notices were sent on 28 May 2003 but the amount of Mr Howe's penalty was stated to be £300,000 both then and thereafter. No explanation of the discrepancy between this amount and the amount of £350,000 resolved by the Committee was made available to us.

23. On 25 June 2003 Mr Tatham sent written representations to the Authority and a marked up version of the warning notice. In his written representations he admitted some matters but said that he did not accept that he knew that he was committing market abuse. Mr Davidson's solicitors sent a two-page letter to the Authority also on 25 June 2003 shortly responding to the warning notice and the investigation report and denying the charges.

The second meeting on 16 July 2003

24. On 10 July 2003 a supplementary case review paper was prepared dealing with three issues of a legal nature raised by the parties in their representations. The first issue was the level of the fines. Each of Mr Davidson, Mr Howe and Mr Tatham had argued that the fines were too high. The paper considered the question of ability to pay and said that Mr Howe and Mr Tatham had been asked to provide details of their resources. There was no discussion of Mr Davidson's point that he was not an approved person and was entitled to rely upon Mr Howe and Mr Tatham, both of whom were approved persons. The second issue concerned Mr Davidson's failure to give a voluntary interview and the decision of the Authority not to compel him to give an interview. It was suggested that Mr Davidson's failure to co-operate should not be said in the decision notice to be an aggravating factor in the level of his penalty but he should be expressed as not benefiting from the discount given to Mr Howe and Mr Tatham for their co-operation "because voluntary co-operation with the Authority's investigations, particularly in market abuse cases, is critical to their successful prosecution and Mr Howe and Mr Tatham should be credited for their assistance". The third issue concerned settlement discussions.

25. The matter was next before the Committee on 16 July 2003 (a Panel of Group A) to consider the written and oral representations following the issue of the warning notice. The Panel considered the supplementary case review paper, the responses received to the warning notice, and oral representations from Mr Tatham. (Mr Davidson did not attend to make oral representations). Mr Tatham said that he substantially agreed with the factual content of the warning notice but did not agree that he had acted without integrity and argued that it was wholly unfair to punish him by the imposition of a financial penalty. The Committee expressed concern that the evidence did not support the allegation that Mr Tatham knowingly and deliberately engaged in market abuse or that he had acted without integrity. Having listened to various telephone conversations between Mr Howe and Mr Tatham the Panel was not persuaded that Mr Tatham had knowingly or deliberately engaged in market abuse and therefore [that his conduct] amounted to dishonesty. However, they agreed that Mr Tatham had been grossly negligent at the very least and for that reason the market abuse charge should stand (intention is not a requirement of market abuse).The penalty of £100,000 should remain to convey the

message that conduct amounting to market abuse carried a heavy penalty. The Panel also heard representations from Mr Howe which went more towards his financial means but decided that the penalty of £300,000 should remain, for the same reason as applied to Mr Tatham. Finally, the Panel considered written representations made on behalf of Mr Davidson and decided to maintain his penalty at £750,000 but wanted it made clear that Mr Davidson's refusal to be interviewed voluntarily had not been treated as an aggravating factor in determining the level of his penalty.

The third meeting on 7 August 2003

26. The matter came back to the Committee (a Panel of Group A) on 7 August 2003 to consider further representations from Mr Howe and Mr Tatham about their ability to pay the penalties. Mr Tatham's penalty was unchanged. As far as Mr Howe was concerned the Panel concluded that it appeared that Mr Howe was unable to pay £300,000 and so decided that the headline figure of £300,000 should remain in the decision notice but that Mr Howe should only be required to pay £50,000 over two years as it was possible that his circumstances might change in the future.

27. The next stage would normally have been the issue of a decision notice but further information then came to light as Mr Davidson's solicitors wrote to the Authority on 22 August 2003 with some records of telephone calls.

28. A supplementary investigation report was prepared on 15 September 2003 when it was reported that Mr Howe had been re-interviewed and that he remained clear that he had had to obtain the permission of Mr Davidson to extend the spread bet in order to complete the placing after the Credo withdrawal. All the current telephone records had been analysed and, although they showed that Mr Davidson and Mr Howe made regular telephone calls to Oystertec, there was no record of a call to support the statement of Mr Howe. The supplementary investigation report accepted that Mr Davidson's mobile telephone had been left at Heathrow by mistake but went on to say that "it seems likely that Paul Davidson had access to other mobile telephones during his holiday … and it is therefore quite possible that Mr Davidson made calls of which we do not have any record".

29. We saw a document entitled "Supplementary Case Review Paper (2)" which was undated but referred to a supplementary investigation report which we assume was that dated 15 September 2003. This case review paper identified four outstanding areas, namely the telephone records, the evidence of Ms Kewley (the telephone operator at Oystertec); the availability of a mobile telephone to Mr Davidson on Barbados and the evidence of Mr Long about the way in which Mr Davidson contacted him from Barbados. The paper indicated that further enquiries might take a considerable time. The paper stated that given the nature of the investigation it was unlikely that the full story would be known until the matter was heard by the Tribunal and that Mr Davidson had stated on many occasions that if a decision notice were issued against him, he would refer the matter to the Tribunal.

The fourth meeting on 18 September 2003

30. The matter was once again before the Committee (a Panel of Group A) on 18 September 2003 to make a decision on the issue of a decision notice. The Panel had

before it the supplementary case review paper and related material. It was minuted that "since that paper [the supplementary case review paper] had been circulated, Leading Counsel had advised that the issue of the Decision Notice should be deferred pending receipt of certain outstanding information". The Panel was told that further information about telephone calls had been received from Mr Davidson's solicitors. These were important because of the Authority's reliance on the evidence of Mr Howe; if the records did not support Mr Howe's version of events the Authority might have to re-consider the cases against Mr Davidson and Mr Howe. The Panel agreed that the issue of the decision notice should be deferred pending further enquiries. We did not see the advice of Leading Counsel referred to in the minutes and were not told what outstanding information should be received.

The fifth meeting on 22 October

31. The matter was again before the Committee (a Panel of Group A) on 22 October 2003 to consider whether to issue a decision notice. The Panel considered the effect of the further information about the telephone calls. While the records confirmed some of Mr Howe's evidence (that certain calls had been made) they did not confirm others (about the crucial timing of the calls) and it was noted "that this evidence had the potential to damage Mr Howe's credibility seriously." The minutes of the Panel noted that the Authority was aware of Mr Howe's vulnerability as a witness and where there was a conflict of evidence which was uncorroborated by documents it was inevitable that matters would depend on who the Tribunal believed at the hearing. However, the Authority considered that such a risk was unavoidable. The Panel noted that:

> "If the evidence of the incoming calls to Mr Howe's mobile were received and did not show calls at the crucial times to corroborate Mr Howe's account of contact with Mr Davidson, then significant doubt would be cast on Mr Howe's version of events, which would seriously undermine the FSA case against Mr Davidson. However, that risk must be viewed against … other evidence independent of the telephone records which supported Mr Howe's version of events. The FSA did not therefore believe that further delay to try to obtain records which it may or may not be able to get was justified."

32. The minutes did not record that Leading Counsel was now satisfied with the evidence. After discussion the Panel agreed with the conclusions reached by the Authority in respect of the evidence. It was also noted that Mr Howe's fine had been reduced to £50,000 to reflect his personal circumstances and financial resources. The Panel resolved that the decision notice as amended be sent to the recipients. Mr Herberg told us at the hearing that the evidence of the incoming calls to Mr Howe's mobile was never obtained but we were not told why.. .

33. The Panel met again on 16 December 2003 to consider representations by Mr Tatham about the amount of his penalty but no reduction was made.

The Decision Notice

34. Meanwhile, on 23 October 2003 the Authority issued one decision notice to Mr Davidson, Mr Tatham and Mr Howe. 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 account of his financial resources and personal circumstances) on Mr Howe and a penalty of £100,000 on Mr Tatham.

35. The penalties were imposed because the Authority was of the view that Mr Davidson, Mr Howe and Mr Tatham had colluded with each other to arrange and enter into spread bets, to cause City Index to enter into a contract for differences with a counterparty (Dresdner); to cause Dresdner to subscribe for a sufficiently large tranche of Cyprotex shares to ensure that the minimum subscription condition to the placing was achieved; and to ensure that the true reason for these actions was not disclosed to those involved in advising Cyprotex or to the market generally through the prospectus.

36. 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.

37. In deciding on the levels of the penalties the decision notice stated that the co-operation provided by Mr Howe and Mr Tatham had been recognized and had resulted in a significant reduction in the level of penalty for each of them.

38. Mr Davidson and Mr Tatham referred the decision notice to the Tribunal. Mr Howe did not.

The Tribunal's Decision

39. The hearing of the references took place on twenty-three days between 18 January and 7 March 2006 and our Decision was released on 16 May 2006. As a preliminary matter we held that market abuse was a criminal charge within the meaning of Article 6 of the Convention at Schedule 1 to the Human Rights Act 1988 and that meant that the burden of proof was on the Authority to prove their case to the civil standard of proof (the balance of probabilities).

40. We heard oral evidence from Mr Davidson, Mr Tatham and Mr Howe. The Authority relied very heavily upon the oral evidence of Mr Howe. Although we had some reservations about the reliability of the evidence of Mr Davidson we bore in mind that the burden of proof was on the Authority to prove its case and not on Mr Davidson to prove his. Having heard Mr Howe give evidence and having seen him as a witness we formed the view that it would be unsafe to rely upon his oral evidence unless it were corroborated by other reliable oral evidence or contemporaneous documents. Mr Howe (who was the nominated broker in the placing) accepted that he had deliberately not informed anyone at his firm about the spread bet. He had concealed the spread bet from the directors of Cyprotex and from the nominated adviser in the placing. He made no attempt to ensure that the bet was disclosed before the flotation either in the prospectus or otherwise. In evidence before us he accepted that at least two of the statements he had made to the Authority had been erroneous. Accordingly, where the evidence of Mr Howe and Mr Davidson conflicted we preferred the evidence of Mr Davidson. Specifically, at

paragraph 239 of our Decision we concluded that the evidence was insufficient for us to conclude that Mr Davidson authorized the increase in the spread bet after the withdrawal of Credo.

41. As far as Mr Davidson was concerned we concluded that, on the evidence before us, the Authority had 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 was concerned, on the evidence before us we were 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. We found that neither sought to conceal any of their actions. At paragraph 219 of our Decision we noted that Mr Davidson's case had been set out as early as 11 April 2002 (in a letter from his solicitors to the Authority) and that the substance of it had not changed.

42. We therefore determined the references in favour of Mr Davidson and Mr Tatham. However, we very briefly considered other questions and concluded 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 were also of the view that there was no regulatory obligation to disclose the spread bet or the contract for differences in the prospectus or elsewhere and so the non-disclosure was not market abuse within the meaning of section 118 of the 2000 Act. In case we were wrong about that we also considered the position if there were an obligation to disclose. On the assumed basis that Mr Davidson and Mr Tatham were complicit in the scheme, we were of the view that they made all appropriate disclosure to the nominated broker, Mr Howe. We also concluded that Mr Davidson and Mr Tatham did not fail to observe the standards of behaviour reasonably expected of them.

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43. We also briefly considered whether the penalties were appropriate on the two assumptions that the Mr Davidson and Mr Tatham 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.

44. Finally we found that Mr Tatham was not in breach of Principles 2 and 3.

The arguments

Mr Davidson

45. Mr Davidson argued that it had been unreasonable for the Committee to have made their decision on 22 October 2003 without having the full telephone records before them and the Committee should have re-evaluated the evidence and considered withdrawing the decision. A similar point could be made about the experts reports; the experts said at the substantive hearing that they did not see anything wrong with the scheme so long as it was disclosed and it had been disclosed to the nominated broker. The Authority should then have withdrawn its decision.

46. Mr Davidson also argued that the decision of the Authority had been unreasonable because the statement in the case review paper recommending that Mr Howe be given a substantial discount to reflect his co-operation with the Authority's investigation proved that the Authority had reduced the penalty levied on Mr Howe as an inducement to Mr Howe to give evidence on behalf of the Authority against Mr Davidson. Mr Davidson accepted the later reduction of the penalty because of inability to pay but argued that the original discount had been applied before ability to pay had been considered.

47. Finally Mr Davidson argued that he was not an approved person and the level of penalty imposed upon him had been unreasonable and no reasons had been given for that level of penalty. The Authority was a very powerful regulator and the erroneous decision it had made had caused him substantial loss. If the Tribunal did not have power to make a costs order in this case then no other applicant would ever come to the Tribunal because it would be cheaper to pay the penalty than ask for justice.

Mr Tatham

48. For Mr Tatham it was argued first that it was unreasonable to impose a financial penalty of £100,000 because it was based on irrelevant and unreasonable considerations. The amount of the penalty had been determined to deter others and exceeded, and was meant to exceed, any penalty which would have been imposed by a criminal court in criminal proceedings for market abuse. If criminal proceedings had been taken the Crown Court would have almost certainly have awarded costs against the Authority but Mr Tatham had had no choice in the matter; he had to bring his proceedings in the Tribunal. Also, the Authority did not take into account any mitigating factors, including the factors that that there had been no financial gain to Mr Tatham; that there was no evidence of any financial loss to any investor; and that Mr Tatham had already suffered loss as he had been disciplined by his employer, and demoted.

49. Next it as argued that it had been unreasonable for the Authority to conclude that there had been any market abuse. The 2000 Act contained new legislation which had only been in place for a couple of months when the behaviour occurred. There was no discussion by the Committee of the legal provisions and no expert legal advice was then taken nor was any expert opinion obtained. Also, there was no analysis of the conditions in sections 118 and 123 of the 2000 Act.

50. Thirdly it was argued that the decision was unreasonable because there were deficiencies in the decision-making process. These had now been corrected as a result of the enforcement process review but at the tine that the decision in these references was made the process still suffered from the deficiencies which had been identified in the review.

51. Finally, it was argued that paragraph 13 of Schedule 13 should not be construed in such a way so as to deter applicants from coming to the Tribunal. The reason why paragraph 13 had been worded in the way it was worded was so as not to deter applicants from coming to the Tribunal.

The Authority

52. For the Authority Mr Herberg argued that a decision could be wrong but not unreasonable and he cited *Timothy Edward Baldwin and another v Financial Services Authority* (2006) Tribunal Decision No. 028 at paragraph 15 and argued that the correct test was whether, given the facts and circumstances which were known, or ought to have been known, by the Authority at the time when the decision was made, the decision was unreasonable..The burden of proof was on the Applicants to show that the decision was unreasonable. Although the Tribunal had held that market abuse was a criminal charge for the purposes of the Article 6 of the Convention, Article 6 did not require a costs order in favour of a successful party. Further, the fact that the charge was a criminal charge for the purposes of Article 6 did not mean that the evidence upon which the Committee based its decision had to be compelling evidence; ENF 15 made it clear that the test in criminal matters was a reasonable, realistic prospect of conviction. Next, Mr Herberg argued that although the Authority, as a public body, should be accountable for its actions, it was important that it should not be inhibited in the performance of its public duties by fear of the financial and other prejudice of being ordered to pay costs and he cited *Paul Michael Baxendale-Walker v The Law Society* [2006] EWHC 643. It also had to be borne in mind that Mr Davidson had chosen not to co-operate with the Authority at the investigation stage. Although Mr Davidson had set out his case as early as 11 April 2002, he did not respond to the more detailed allegations which were sent to him later.

53. Mr Herberg accepted that the Tribunal should have regard to the process by which the Committee came to its decision but argued that the documentary evidence showed that the Committee conscientiously and reasonably considered the evidence and came to decisions (to issue the warning notice and the decision notice) which were reasonable and proper bearing in mind the limited opportunity for the Committee to test the evidence and the law. In evaluating the reasonableness of the decision it had to be borne in mind that the Committee was an administrative body and not a court of law; it did not have the advantage of the extensive process of investigation of fact and law which the Tribunal undertook in this case. The levels of the penalties were reasonable and the Committee were entitled to have regard to the seriousness of market abuse as a charge.

54. Finally, Mr Herberg argued that the original discount given to Mr Howe in respect of his penalty was at the stage of the investigation and for co-operating in the investigation. The discount had not been given as an inducement to Mr Howe to give evidence at the hearing as by the time of the hearing the penalty had already been reduced to £50,000.

55. Mr Herberg added that the provisions in paragraph 13 of Schedule 13 of the 2000 Act were also of assistance to applicants because if an applicant lost his case before the Tribunal he did not have to pay the Authority's costs unless he had acted vexatiously, frivolously or unreasonably.

Reasons for Decision

(1) Was the disputed decision unreasonable?

56. The first matter we have to decide is whether we consider that the decisions of the Authority which were the subject of the references were unreasonable within the meaning

of paragraph 13(2) of Schedule 13 of the Financial Services and Markets Act 2000 (the 2000 Act).

57. We begin by considering the authorities cited to us to identify the legal principles which we should apply. Mr Herberg relied upon *Baxendale-Walker* which did not concern paragraph 13(2) of Schedule 13. There the appellant was charged by the Law Society with conduct unbefitting a solicitor and a number of allegations were made. Before the Solicitors Disciplinary Tribunal one of the allegations was dismissed and the Tribunal ordered that the Law Society should pay 30% of the appellant's costs and that the appellant should pay no costs to The Law Society. At paragraph 43 of his judgment Moses LJ, relying upon general legal principles, said:

> "43. The question thus arises as to whether the order that the Law Society should pay a proportion of the appellant's costs and that no costs should be paid by the appellant was correct, as matter of law. The principles, in relation to an award of costs against a disciplinary body, were not in dispute. A regulator brings proceedings in the public interest in the exercise of a public function which it is required to perform. In those circumstances the principles applicable to an award of costs differ from those in relation to private civil litigation. Absent dishonesty or a lack of good faith, a costs order should not be made against such a regulator unless there is good reason to do so. That reason must be more than that the other party has succeeded. In considering an award of costs against a public regulator the court must consider on the one hand the financial prejudice to the particular complainant weighed against the need to encourage public bodies to exercise their public function of making reasonable and sound decisions without fear of exposure to undue financial prejudice if the decision is successfully challenged.
> …
> 45 In the instant appeal, in my view there was no basis for the order made by the Tribunal. The only ground on which it relied was that the appellant had been successful in his defence of the first allegation. That was not a sufficient ground to order the Law Society to pay any of his costs. There was no finding that the allegation was misconceived, without foundation or born of malice or some other improper motive. In those circumstances the order was without foundation."

58. Because of the provisions of paragraph 13 of Schedule 13 we do not have to apply all the principles identified in *Baxendale-Walker*. In particular, we do not have to look for dishonesty, or a lack of good faith, or an improper motive on the part of the Authority. The legislation tells us that what we have to identify is whether the decision was unreasonable. However, the other principles, including the principle that success alone does not give an entitlement to costs, also applies to these applications. We adopt the views of the Tribunal in *Baldwin* (2006) which was concerned with the legislation which we have to apply. At paragraphs 7 and 15 of its Decision the Tribunal said:

> "7. We do not consider that reference to the *Wednesbury* [*Associated Provincial Picture Houses Limited v Wednesbury Corporation* [1948] 1 KB 223, CA] test is appropriate, helpful or conducive to clarity in the present context. The Tribunal, unlike the court in the *Wednesbury* case, is expressly directed by paragraph 13 to make its own judgment of what is reasonable: "(1) If the Tribunal

> considers that a party … has acted … unreasonably … (2) If the Tribunal considers that a decision of the Authority … was unreasonable".
>
> 15. Under paragraph 13(2) [of Schedule 13 of the 2000 Act] we are required to focus on the decision itself. In our judgment the right approach is to ask ourselves whether we consider that the Authority's decision was unreasonable, given the facts and circumstances which were known or ought to have been known to the Authority at the time when the decision was made. In taking this approach we remind ourselves that the process leading to the FSA's decision was not a full judicial hearing of the kind conducted by the Tribunal. As the Tribunal said in the case of *Legal and General Assurance Society Limited v Financial Services Authority* [Tribunal Decision No. 015]: "When dealing with a large volume of regulatory matters informally and speedily, FSA should not be expected to follow procedures, or express its conclusions, as required of a court" (paragraph 29).

59. From the arguments of the parties we have identified three elements of the disputed decision which they claim were unreasonable, namely, the approach to the evidence and the facts; the approach to the law; and the level of the penalties. (We do not consider the argument that the Authority should have proceeded against other parties as that was not a matter which was the subject of the references before us. On the facts we do have the decision seems surprising but we do not have sufficient evidence to decide whether a decision not to proceed against other parties was or was not unreasonable.)

Was the approach to the evidence and the facts reasonable?

60. Beginning with the approach to the evidence and the facts it is quite clear that the Committee knew that the case involved many significant conflicts of evidence between Mr Davidson and Mr Howe. The Committee knew that Mr Howe had a pivotal role in the matter. At the meeting on 23 October 2003, when they resolved that the decision notice be issued, the Committee knew that there was evidence about the telephone records that "had the potential to damage Mr Howe's credibility seriously". The Committee also knew that the Authority was "aware of Mr Howe's vulnerability as a witness" and that "where there was a conflict of oral evidence matters would depend upon whom the Tribunal believed at the hearing."

61. The Committee also knew, or ought to have known, that Mr Howe was an approved person and was the nominated broker in the placement. He had deliberately not informed anyone at his firm about the spread bet and his employment with his firm had terminated after an internal investigation. He had concealed the spread bet from the directors of Cyprotex and from the nominated adviser in the placing. He had made no attempt to ensure that the bet was disclosed before the flotation either in the prospectus or otherwise. On the other hand there was no proof that Mr Davidson had lied or been dishonest and there was no evidence that he had colluded or agreed to ensure non-disclosure. The Committee also knew that Mr Howe had been interviewed and that Mr Davidson had not been interviewed and ought to have known that an interview is of assistance in forming a view as to the credibility of a person as a witness giving oral evidence. The Committee knew the outlines of Mr Davidson's case and that he denied all the allegations. Nevertheless they decided to prefer the evidence of Mr Howe throughout

and to assume that the facts were as Mr Howe said they were. It was on the basis of those assumed facts that the penalties were imposed. Finally, in evaluating the evidence there was no discussion of the burden of proof

62.. Bearing in mind all the factors we have mentioned we are of the view that the decision to prefer the evidence of Mr Howe was unreasonable in the particular circumstances of this case. We do not regard the position of the Committee as being the same as that of a prosecutor in a criminal case. The prosecutor makes no decision which is binding on an individual and imposes no penalty; he decides whether he has enough evidence to succeed knowing that the binding decision is made by the court and that the court will impose the penalty. However, the decisions of the Committee are binding decisions (unless referred to the Tribunal which could be a very expensive process) and we are of the view that such binding decisions, especially on serious matters such as those in this case, should be based on cogent evidence. At the very least the Committee could have considered whether the Authority should interview Mr Davidson under compulsory powers and could have made every possible effort to obtain the fullest telephone records. At some stage the advice of Leading Counsel on the evidence was taken and he advised that the issue of the decision notice should be deferred pending receipt of certain outstanding information. There was no minute recording that all that information had been received and that Leading Counsel was satisfied with the evidence before the decision notice was issued. The Committee could have considered whether to take further legal advice on the evidence and the burden of proof. Finally, the decision notice referred to collusion and concealment but there was a complete lack of direct evidence of either collusion or concealment. Indeed the Committee knew, or ought to have known, that Mr Howe acknowledged that Mr Davidson would not do anything illegal.

63. In our view the decision-making process at the time of the disputed decision had the defects identified in the enforcement process review, namely that before the case was referred to the Committee there was no dedicated legal function independent of the Enforcement Division to assist the Committee in its decision-making . .

Was the approach to the law reasonable?

64. Turning to the Committee's approach to the law about market abuse we are of the view that the Committee should have further explored the concept of the regular user and should have asked for an analysis of the application of the relevant rules of the alternative investment market and the provisions of the Code of Market Conduct. The Code of Market Conduct states that it imposes no new disclosure obligations but neither the draft warning notice nor the Committee considered what disclosure rules were applicable and whether they had been breached. This was brand new legislation which had not previously been tested. The expert evidence before us was that the regular user would not regard the actions of Mr Davidson and Mr Tatham as market abuse if they had been disclosed to the market in the prospectus. One of the proper persons to make such disclosure was Mr Howe and, on the assumed basis that Mr Davidson and Mr Tatham were complicit in the scheme, they had made all appropriate disclosure to Mr Howe. In our view the lack of a thorough legal review of this important matter was unreasonable in all the circumstances.

Were the levels of the penalties reasonable?

65. Finally, we turn to the level of the penalties and first consider whether it was reasonable to decide not to take criminal proceedings on the ground that they would give rise to a lower penalty because of the three mitigating factors of no personal gain; no financial loss to investors and the loss suffered by Mr Tatham and Mr Davidson. In our view it was not reasonable to decide against criminal proceedings on the ground that a higher penalty could be imposed by a civil penalty. It was also unreasonable to proceed to ignore the same mitigating factors as would have applied in criminal proceedings to reduce the level of the penalty. We deal further with mitigation below.

66. One of the reasons given in the case review paper of 12 May 2003 for the level of penalty imposed on Mr Davidson was that he was not an approved person and so could not be subject to a prohibition or withdrawal of approval. However, section 56 of the 2000 Act, which contains the provisions applicable to prohibition orders, specifically applies to any individual and is not limited to approved persons. Thus this reason for the level of penalty imposed on Mr Davidson was not reasonable.

67. In considering the level of the penalty imposed on Mr Davidson we have also considered that imposed on Mr Howe but as a comparison only. The original recommendation was that Mr Davidson's penalty should be £500,000 (based on the assumption that he was the instigator of the scheme for which there was no documentary evidence in support, only the "vulnerable" evidence of Mr Howe). The original recommendation was that Mr Howe's penalty should be £250,000 as "his actions would not have succeeded if it had not been for his complicity with Mr Davidson" (again based on inadequate evidence). Also, Mr Howe's penalty was significantly discounted to reflect his co-operation. We were not told of the original amount of Mr Howe's penalty which was discounted; nor the amount of the discount, only the net amount. However, in our view the differential between the two penalties did not adequately reflect the fact that Mr Davidson was not an approved person and that Mr Howe was. In our view a penalty levied on an approved person should in principle be higher because the approved person has higher obligations.

68. The amount of Mr Davidson's penalty was increased by the Committee on 21 May 2003 by £250,000 to a very high level of £750,000 "to reflect the seriousness of his culpability and to send a very strong message to the market". The amount of Mr Howe's penalty was increased by only £100,000 to £350,000 for the same reasons (although in fact the figure used thereafter was always £300,000 for some unexplained reason). In his representations following the warning notice Mr Davidson made the point that he was not an approved person and was entitled to rely on Mr Howe and Mr Tatham. These representations were considered by the Committee on 16 July 2003 but the levels of penalty were maintained.

69. In our view the amount of the final differential between the penalties imposed on Mr Davidson and on Mr Howe was not reasonable.

70. Turning to the penalty imposed upon Mr Tatham we refer to the discussion by the Committee on 16 July 2003 when they heard oral representations from Mr Tatham. They then expressed concern that the evidence did not support the allegation that Mr Tatham

knowingly and deliberately engaged in market abuse and they were not persuaded that he had knowingly and deliberately engaged in market abuse. Yet they did not reduce his penalty. Further the Committee did not take account of section 123(2) of the 2000 Act which provides that 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 he believed, on reasonable grounds, that his behavior did not amount to market abuse. We are of the view that after hearing Mr Tatham's representations it was unreasonable of the Committee not to form the view that Mr Tatham reasonably believed that his behaviour did not amount to market abuse and that consequently they did not have the legal power to impose the penalty. Again, the decision-making process at the time of the disputed decision had the defect that there was no dedicated independent legal function to assist the Committee with legal advice and support.

71. We considered the level of both penalties in our Decision and said:

> "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".

72. Although the decision notice took account of some of these factors it did not take account of them all and we are of the view that it was unreasonable of the Committee not to mitigate the levels of the penalties more than they did.

73. Before leaving the subject of the penalties we recall that Mr Davidson argued that the original discount applied to Mr Howe's penalty was an inducement to him to give evidence against Mr Davidson. We would regard a suggestion that the Authority offered financial inducements to witnesses to give oral evidence on its behalf as a very serious allegation indeed which would require more compelling evidence than we received to support it.

74. We conclude that the decisions of the Authority which were the subject of the references were unreasonable within the meaning of paragraph 13(2).

75. We would like to add that the matters which we have identified as being unreasonable are unlikely to re-occur in the future as the decision notice in these references was issued before the many changes in the decision-making process, recommended by the enforcement process review of 2005 were implemented.

(2) Did the Authority act unreasonably in the proceedings?

76 The second matter which we have to consider is whether the Authority acted vexatiously, frivolously or unreasonably in connection with the proceedings within the meaning of paragraph 13(1). In this context we consider the argument of Mr Davidson that the Authority should have kept the proceedings under constant review and withdrawn the disputed decision when they realized that the evidence had gone against them. We were assured by Mr Herberg that the Authority did keep the proceedings under constant review. A decision whether to withdraw a disputed decision during the course of proceedings is a matter of judgment upon which different minds may reach different views. We consider it unfortunate that the Authority allowed the proceedings to continue after all the evidence and expert evidence had been adduced but we cannot say that it was unreasonable not to withdraw the disputed decision during the course of the hearing.

Decision

77 As we are of the view that the decision of the Authority which was the subject of the references was unreasonable WE DIRECT that the Authority shall pay the costs or expenses incurred by Mr Davidson and Mr Tatham in connection with the proceedings, including the costs hearing on 7 September 2006. This is a unanimous decision.

78 In order to save the parties the costs and expenses of yet a further hearing we declare that we are minded to direct that the amount of the costs or expenses should be assessed on the standard basis by a costs official of the court under Rule 21(3)(b). If any party wishes to make representations on this direction then he should notify the Secretary of the Tribunal within twenty-one days of the date of the release of this Decision; if no such representations are received then such a Direction will be made. .

DR A N BRICE

CHAIRMAN

RELEASE DATE:

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