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“... serious example of insider dealing by a person in a key position of responsibility and trust.”

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RECENT ENFORCEMENT CASES: MARKET ABUSE AND INSIDE INFORMATION

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Overview

In May 2008 the FSA set out the methods by which it is seeking to tackle Market Abuse through “credible deterrence”. As part of this, the FSA warned that the industry should expect more market abuse cases to be pursued through the criminal courts (since this time, four individuals have been charged or prosecuted for insider dealing), and that financial penalties for civil cases will increase. We have seen a number of market abuse enforcement cases in recent months in which the FSA have set out “lessons to be learnt”. There have also been cases of companies being fined for failing to disclose inside information to the market in a timely manner. This note summarises the background to a selection of recent cases.

Richard Ralph, Filip Boyen and Erik Boyen

These related cases were announced in November 2008 and January 2009 and relate to the dealing in the shares of AIM-listed Monterrico Metals PLC (“Monterrico”) on the basis of inside information. Mr Ralph, the former Chairman of Monterrico, was aware that a proposed takeover offer of Monterrico by a Chinese mining consortium was likely to be approximately 35% higher than had been announced to the market. On this basis he asked Mr Filip Boyen to buy Monterrico shares on his behalf. Mr Filip Boyen in turn purchased shares for himself and disclosed the inside information to his brother Mr Erik Boyen, who subsequently traded and encouraged another party to deal in Monterrico shares. All three individuals were issued with punitive fines and had their profits disgorged.

Of interest here is that:

- the FSA confirmed that AIM, whilst not a regulated market, is a prescribed market and accordingly that trading in AIM-listed securities is subject to the rules on market abuse; and
- although Mr Ralph voluntarily disclosed his actions to and co-operated extensively with the FSA, his overall fine still included a punitive element of £105,000 in view of the seriousness of this insider dealing by a person in a key position of responsibility and trust. But his cooperation was a major factor in the FSA deciding not to bring a criminal prosecution against him.

Stuart McKegg and Brian Taylor

The FSA announced in December 2008 that they had fined Mr McKegg and Mr Taylor for dealing in the shares of AIM-listed Amerisur Resources PLC (“Amerisur”) on the basis of inside information. Amerisur’s NOMAD had contacted both individuals in May 2007 to invite them to participate in a placing. The NOMAD explicitly set out that the information was inside information and that Mr McKegg and Mr Taylor should neither

“... justifying non-disclosure ... by offsetting negative and positive news is not acceptable.”

disclose nor trade on the basis of this information until news of the placing was announced the following day. Despite this, both individuals immediately instructed their brokers to sell their entire existing holding in Amerisur shares, and at the same time confirmed to the NOMAD that they would participate in the placing, ultimately making a trading profit. Both Mr McKegg and Mr Taylor had their profits disgorged by the FSA, and would have each been issued with a punitive fine of £20,000 had it not been for their specific financial circumstances.

Wolfson Microelectronics PLC and Entertainment Rights PLC

In January 2009 the FSA in its capacity as the UK Listing Authority announced that it had fined LSE-listed Wolfson Microelectronics PLC (“Wolfson”) £140,000 for failing to disclose inside information to the market as soon as possible, leading to a false market in Wolfson shares for a period of 16 days. This represented a breach of the Disclosure and Transparency Rules (“DTR”) and Listing Principle 4.

By way of background, in March 2008 a major customer gave Wolfson both negative and positive news which, when considered together, resulted in expected revenues from that customer being broadly the same as in the preceding year. Senior Management decided in conjunction with advice received from Wolfson’s Investor Relations Adviser that the negative news did not constitute inside information requiring to be announced, partly because it was expected to be offset by the positive news and because revised earnings were still in line with market expectations. Some two weeks later, Wolfson sought confirmation from its lawyers and corporate brokers as to whether it had taken the correct course of action. Both recommended that Wolfson announce the negative news to the market on the basis of the importance that the market placed on the major customer. Wolfson’s share price immediately fell 18%.

Similarly, in January 2009 FSA announced that it had fined Entertainment Rights PLC (“Entertainment Rights”) £245,000 for failing to disclose insider information to the market in a timely manner. The firm had received news which resulted in an anticipated fall in annual profits of US\$13.9 million, but thought that other opportunities might arise which would negate this fall. 78 days later Senior Management revised its view and announced the inside information to the market, resulting in a fall in the Entertainment Rights share price of 55%.

There are 3 key messages arising from these cases:

- the offsetting of positive and negative news is not acceptable (in particular when there is mere hope of positive news); instead, listed companies should disclose both types of information and give the market the opportunity to determine whether they cancel each other out;
- listed companies are not able to withhold inside information on the basis of confidentiality agreements they might have in place with customers; and
- primary responsibility for adherence with the requirements of the DTR lies with the listed company and not with an Investor Relations Adviser.

Conclusions

We have seen in the past month or two that the FSA are becoming increasingly keen to create a ‘credible deterrence’ to market abuse through larger, punitive fines (as well as disgorging profits, where relevant). The penalties for failure to disclose information promptly are further evidence of the FSA's determination to ensure that markets are clean, orderly and efficient.

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