

**SELF-REGULATION: THE BRITISH APPROACH TO POLICING CONDUCT  
IN THE SECURITIES BUSINESS, WITH PARTICULAR REFERENCE  
TO THE ROLE OF THE CITY PANEL ON TAKE-OVERS AND MERGERS  
IN THE REGULATION OF INSIDER TRADING**

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Recently there has been growing dissatisfaction in Britain about the structure of regulation in the securities industry. Traditionally it has been left a law unto itself, with legal regulation rarely intervening [1]. The reasons are largely historic and are of little relevance except with regard to one vital factor: the "village atmosphere of the City of London". Bred not only through proximity but also through a common heritage and class system, this facet of the City casts the various sections of the industry in the form of "gentlemen's clubs". Although the ethics of the City might have been higher in theory than in practice, transgressions from the accepted norms of the group were visited with severe professional and social sanctions [2]. With the changed economic situation and, possibly, the break-up of clearly defined social groupings in British society [3], this capacity for the City to keep its own house in order has probably weakened.

Certain aspects of the securities industry are regulated by law, particularly with regard to the licensing of securities dealers and in the field of insurance. Even in such areas as these, however, considerable emphasis is still placed on self-regulation. It is, for example, not necessary for a securities dealer to obtain a license if he is, *inter alia*, a member of certain recognized self-regulatory bodies. It is not possible to describe in a short article the present regulatory structure in operation in Britain, since it is far too complex [4]: it is a curious amalgam of official and semi-official regulatory bodies, such as the Department of Trade, Bank of England, Metropolitan and City of London Company Fraud Department, Council of the Stock Exchange, and a host of associations and professional bodies. It may be of greatest interest to fasten upon one of these agencies which, perhaps more than any other, typifies the

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role and nature of self-regulation in Britain. This is the City Panel on Take-overs and Mergers.

### 1. The City Panel on Take-overs and Mergers and the City Code on Take-overs and Mergers

The great boom in take-over and merger activity in the mid 1950's showed that the then-existing structure of regulation was wholly unable to restrain the excesses perpetrated in the frenzied climate of contested take-overs [5]. It has been observed that

[B]itterness and division ran deep. The network of gentility and politeness broke down completely. Far from keeping in touch with each other, the opposing merchant banks indulged in personal animosity . . . [t]he worst aspect of the matter . . . was that the public had a ringside seat to observe that when it came down to ethics and propriety the top figures of the City . . . were at each others' throats [6].

Under a great deal of internal as well as external pressure, the Governor of the Bank of England called together a number of leading City institutions to create the City Working Party, which drew up the Notes on Amalgamations of British Businesses [7]. Whilst the Notes were hardly radical, the London Stock Exchange greeted them as "an early shot in the campaign to get rid of the unethical, and to prevent operations which at best might be viewed with distaste" [8]. The Notes were little more than a code of good practice but did emphasize the need for equality of treatment among shareholders, the making of reasonable corporate disclosures and the avoidance of undue disruption of the securities markets.

Abuses continued, however [9]. The City Working Party was reconvened, and in 1963 the Revised Notes on Company Amalgamations and Mergers were published [10]. The most interesting addition was the attention that the Notes gave to insider trading. In particular the need for "timely and equal information on all relevant matters . . . to all the shareholders" was underlined. It should be noted that the Notes did not expressly forbid insider trading although this was probably the fair implication of the various principles the Notes expressed. Although the Board of Trade had issued its Licensed Dealers (Conduct of Business) Rules [11] in 1960 (which imposed a degree of regulation on take-overs and on the issuance of circulars in which licensed dealers were involved), within a year or so of the promulgation of the Revised Notes a number of take-over battles and market operations occurred which substantially destroyed the City's attempt at self-regulation [12].

There followed widespread disquiet and loud calls for the establishment of a regulatory body of the kind typified by the United States Securities and Exchange Commission. The City Working Party was reconvened "as a matter of urgency" [13], and within a month the Governor of the Bank of England announced that

agreement had been reached among the City institutions to set up a panel to administer a new code on corporate amalgamations [14], under the chairmanship of a former deputy governor of the Bank of England. The Panel on Take-overs and Mergers was established in March, 1968.

The Panel consisted of nine persons nominated from the various constituent City institutions, with a relatively small secretariat provided by the Bank of England [15]. From the outset the Panel made it clear that apart from acting as a supervisory body it was available for consultation and advice [16]. Whilst acknowledging the dangers of being accused of bias and of creating confusion, the Panel also made it clear that it would adopt an active and interventionist approach and not remain merely a passive onlooker. Almost immediately the Panel was faced with a series of dramatic and extremely difficult cases where its authority was openly challenged by certain City institutions. One important sanction available to the Panel was referral of a particular case to one of its constituent bodies, with the expectation that disciplinary proceedings would be taken against the individuals concerned. However, the constituent institutions were not always prepared to do this or at least did not act with sufficient enthusiasm [17], and the ability of the Panel to fulfill its role was hampered. This absence of any effective sanctions did not go unrecognized. Lord Kearton, the Chairman of Courtauld's, in a television interview on June 27, 1968, aptly observed,

[T]he cult of the gifted amateur is the new Take-over Panel's main defect. It has no teeth, no legal sanctions — in fact to me it's all a kind of confidence trick.

The Governor of the Bank of England issued several press releases warning the City that the present state of affairs would not be allowed to continue. In an open letter to the City the Governor stated,

[T]he result . . . has been less than satisfactory. Much resentment has been aroused. The Panel's rulings have been questioned and even their general authority has not always been acknowledged. It is in no one's interest that this state of affairs should continue.

Disquiet in Parliament grew [18] and it was obvious that the scheme of regulation would have to be strengthened. It is doubtful whether the then Labour Government would have wished to see a statutory securities and exchange commission imposed. The Prime Minister at the Lord Mayor's Guildhall Banquet made it clear that he would prefer to see the City keep its own house in order [19], and plans were made to strengthen self-regulation.

The Panel was reorganized and reconstituted under Lord Shawcross and an Appeals Committee was set up under Lord Pearce [20]. Furthermore, a full-time Executive under a Director General was created, with the members essentially practitioners in the securities industry and related fields and, in the main, appointed on a basis of secondment from the various City institutions. This was to ensure a

degree of topical expertise and practical ability which would not normally be available in a regulatory agency of this type.

The most important development was the Panel's promulgation of a Statement of Policy which had been drawn up with the support of the various constituent institutions and endorsed by the Board of Trade. This statement, whilst affirming adherence to the principles of self-regulation, stated that there was a need to

place beyond doubt the Panel's determination that the voluntary system should both function effectively and command the respect of all those concerned with it.

The Statement announced that the Panel would have increased powers to see to the imposition of sanctions.

If there is a breach of the Code the Panel will have recourse to private or to public censure [21], or in more flagrant cases to further action designed to deprive the offender temporarily or permanently of his ability to practice in the field of take-overs and mergers.

The Panel's powers were strengthened by the Council of the Stock Exchange, which altered its rules so as to provide that a determination of the Panel with regard to the Code would be automatically accepted as binding by the Council, although the disciplinary sanction would remain within the Council's discretion [22]. Where licensed dealers are involved in a violation of the "letter and spirit of the Code", the Statement made it clear that if

the breach . . . was of such a nature that public reprobation might not be an adequate sanction, the Panel would report the matter to the Board of Trade inviting them to take the report into consideration with a view to the possibility of action under the Prevention of Frauds (Investment) Act 1958 (*i.e.*, the revocation of a license or exemption).

The Statement added that the Panel had been assured by the Board of Trade that "they will take into prompt consideration the facts relevant to the exercise of their powers disclosed in any such report by the Panel".

The Statement also referred to the possibility of the Panel requesting the Stock Exchange to suspend trading in a particular security or even to delist the issuer. In addition, in transactions involving exchange control permission, the Panel stated that it would keep in close contact with the relevant officials in the Bank of England so as to ensure "that the conditions under which consent is granted are properly observed".

One of the basic principles of the Code is that "to be effective the system cannot be static and inflexible and from time to time its revision will be necessary in the light of experience" [23]. In its present form the Code consists of a series of fourteen General Principles implemented by thirty-nine detailed Rules. From time to time the Panel issues so-called Practice Notes embodying rulings and interpretations

of certain of the General Principles as well as of the Rules. The Notes are "intended to serve as a guide only and are subject to amendment in the light of experience" [24]. To illustrate the impact that the Code and authority of the Panel have had, this article will trace the experience of the Panel in one small area of its concern, insider trading.

## 2. The Panel, the Code and the regulation of insider trading

Insider trading in corporate securities is not unlawful in the United Kingdom [25], although it may soon be in specific circumstances under Part V of the Companies Bill 1978 [26]. Clause 57 of this Bill will make it a criminal offense to knowingly make use of, or tip, price-sensitive information which is not generally available and which the trader or tipper has obtained through his insider position or knowingly from an insider. However, it should be noted that this offense covers trading only on the Stock Exchange and on certain other anonymous markets, such as that provided by ARIEL [27]. No provision is made for any form of civil liability for insider trading in such circumstances. In the case of non-market transactions, even in listed securities, the insider must disclose his insider status, not his inside information. If an insider fails to do this, apart from committing a criminal offense, his non-disclosure is constituted a deliberate misrepresentation [28]. The common law does not appear to cast a duty upon corporate fiduciaries as such [29], when dealing in the securities of their companies, to make adequate disclosures of any price-sensitive information that they might possess [30]. Of course, it is probable that in certain circumstances corporate fiduciaries would be accountable to their corporations on the basis of the "secret profits" rule [31], or possibly for breach of confidence [32]. Since 1948 the Companies Acts have contained provisions, which have been constantly reinforced and strengthened, requiring directors to report their transactions to the company [33]. Thus apart from the obligation on directors to disclose their dealings in their companies' securities, the regulation of insider trading in Britain has been wholly a matter of self-regulation. Moreover, although insider trading is not, of course, confined to take-overs and mergers, its regulation has been almost solely dependent upon the Code [34].

To the degree that they aim to achieve equality of information to shareholders, all the provisions of the Code are relevant to insider trading. Attention will be given here only to those provisions directly in point. In the Introduction to the Code, it is made clear that "the City Code has not and does not seek to have the force of Law", that it merely represents "the collective opinion of those professionally concerned in the field of take-overs and mergers on a range of business standards". The observance of the Code is the price that must be paid for having the facility of the securities markets. The Code states that, whilst it applies primarily to those actively engaged in the securities industry, it

will also apply to directors of public companies or persons or groups of persons who seek to

gain control . . . of public companies, and professional advisers . . . even where they are not directly affiliated to the bodies who are responsible for this document [35].

Although *prima facie* it might seem that the Panel's sanctions extend only to publicly listed companies, all commercial enterprises eventually have to look to the City institutions for finance, at least to some extent, and will thus subject themselves to the Code. Indeed ARIEL has already agreed to require strict observance of the Code by its subscribers and listed companies [36]. The Code itself states,

The City Code is drafted with listed public companies particularly in mind. Nevertheless, the spirit of the City Code and where appropriate the letter will also apply to take-overs of unlisted public companies. The City Code will not apply, however, to cases where the offeree company is a private company, nor will it normally apply to take-overs of companies which are not resident for exchange control purposes in the United Kingdom [37].

The basic rule underlying the Code (and to that extent also the Rules and Regulations of the Stock Exchange) is expressed in General Principle 5:

It must be the object of all the parties to a take-over or merger transaction to use every endeavor to prevent the creation of a false market in the shares of the offeror or offeree company [38].

In addition to emphasizing the need for equality of treatment and that "no relevant information" should be withheld from shareholders in a take-over or merger [39], the Code provides, in General Principle 10, that during the course of a take-over or merger, or when such is in contemplation, neither the offeror, offeree nor their respective advisers are to provide information to some shareholders which is not made available to all shareholders [40]. This does not apply to the furnishing of information in confidence, by the offeree company to a bona fide potential offeror, or vice versa. Nor does it apply to the issuance of circulars by members of the Stock Exchange, who are brokers to a participant in the transaction, to their investment clients provided the issue has been cleared in advance by the Panel.

The Panel has on a number of occasions expressed concern at the privileged disclosure of price-sensitive information to selected shareholders. In support of General Principle 10 the Panel has issued a Practice Note on the Publication of Information [41]. In this Note the Panel does not preclude the possibility of corporate managements holding briefings for shareholders provided certain safeguards are observed. Basically such a meeting should not take place until the offer document has been published and the offeree company has published its views. All shareholders should be sent invitations to the meeting, but in exceptional circumstances the Panel may be prepared to accept a general invitation to shareholders advertised in the press. The press and news agencies should always be invited to such meetings and if at the meeting any material information previously undisclosed is made available, a circular giving details should be sent to the shareholders immediately. In

certain circumstances, such as in the closing stages of a take-over bid, disclosure through newspaper advertisements might be required. Given the difficulty of explaining complex financial issues in the media, the Panel prefers that disclosure of price-sensitive information be by circulars rather than by television or radio. Where any such information is disclosed in a radio or television interview the Practice Note imposes an obligation on the persons concerned to circularize the shareholders. The Panel does not wish to prevent brokers who are associated with participants in a take-over from giving their own clients material on the companies involved in the transaction, but in all events fresh information must not be restricted to a small privileged group. In particular information to clients should not include any statements of fact or opinion based upon otherwise unavailable information. Finally, clearance of circulars by the Panel is generally required.

Certain provisions of the Code are directly relevant to insider trading in the context of take-over and merger transactions. Rule 7 emphasizes "the vital importance of absolute secrecy before an announcement". However, under Rule 5, a firm intention to make an offer must be disclosed to the shareholders as soon as it is communicated to the board [42]. Where approaches have been made which might lead to an offer, as soon as the parties are reasonably confident as to the successful outcome of the negotiations a release should be made. Rule 5 further provides that

In any situation which might lead to an offer being made . . . a close watch should be kept on the share market; in the event of an untoward movement in share prices an immediate announcement, accompanied by such comment as may be appropriate, should be made.

In April, 1977 the Panel and the Stock Exchange sought to reinforce these provisions by publishing a Joint Statement on the Announcement of Price-Sensitive Matters. In this Statement the Panel and the Stock Exchange observed that in their experience where trading had taken place upon the basis of inside information, it had been by tippees and persons dealing upon the basis of rumors, and not by insiders. Thus the problem was essentially one of security and confidentiality. Where such a number of persons is involved as to render confidentiality difficult to maintain, the company concerned should make a public announcement. Furthermore, the Joint Statement underlines the importance of companies developing internal guidelines and procedures for its employees and executives with regard to the handling of confidential information. Reference was also made to Section 4(g) of the Stock Exchange's Listing Agreement under which listed issuers are obliged to disclose to the Stock Exchange "any . . . information necessary to enable the shareholders and the public to appraise the position of the company and to avoid the establishment of a false market in its securities". The Stock Exchange also indicated that it would be far more prepared to halt trading temporarily where it was evident that material undisclosed information was in the market.

The current edition of the Code (1976) significantly tightens up earlier provi-

sions relating specifically to insider trading. Rule 30 provides,

All persons concerned with the consideration and discussion of any proposed offer must treat the information related to the potential offer as secret and must not pass it to any other person unless it is necessary to do so. Furthermore, such persons must conduct themselves so as to minimize the chances of an accidental leak of information.

Whilst this restriction arose by implication from the provisions of an earlier edition of the Code (1974), the rule against insider trading and tipping was not explicit. The present Rule continues:

No dealings of any kind (including option business) in the securities of the offeree company by any person, not being the offeror, who is privy to the preliminary take-over or merger discussions or to an intention to make an offer may take place between the time when there is reason to suppose that an approach or an offer is contemplated and the announcement of the approach or offer or the termination of the discussions [43].

Furthermore,

[N]o such dealings shall take place in the securities of the offeror except where the proposed offer is not deemed price sensitive in relation to such securities.

Without prejudice to the generality of the above provisions, the Code in Rule 30 provides that certain persons shall be regarded as being privy to the inside information, "assuming he has received the relevant information". These are: a director or employee of the companies involved in the transaction, a professional adviser either to one of the companies or to a director or employee of such a company, and a person who receives the information "in the context of a confidential relationship and it was necessary that he received such information". Furthermore, the spouses, close relatives and related trusts of such persons are deemed to be in the same position as those persons.

It should be noted that the offeror is not precluded from acquiring securities in the offeree company during this period. It seems that the Panel considers that where the potential offeror is not in possession of inside information other than its own intentions it should not necessarily be barred from trading [44]. However, in Practice Note 9, the Panel specifically states that this exemption

does not apply to cases where the offeror would be precluded from dealing under ordinarily accepted standards of business behaviour, *e.g.* where the offeror has been supplied by the offeree company with confidential price-sensitive information in the course of take-over or merger discussions.

Many potential offeree companies and their professional advisers will give confidential information to potential offerors only on the understanding that it is treated as secret and confidential; this is apparently commonly a contractual obligation.



Where an announcement has been made that the companies are negotiating for a take-over or merger, or that an approach is likely, and the discussions are thereafter terminated or no firm offer is made, no dealings in the securities of the offeree company by the offeror (or by any persons or companies privy to the intention to terminate the discussions or to the decision not to proceed with the offer) may take place prior to the public announcement that the discussions have been terminated or that there will be no offer [45].

Although Rule 30 establishes absolute prohibitions against dealings during preliminary states of a take-over or merger transaction, Rule 31 asserts that “[s]ave in so far as appears from the Code, it is considered undesirable to fetter the market”. Accordingly the Rule provides for freedom of dealing in the shares of the offeror or offeree companies by parties to such a transaction (or by their associates) during the offer period. However, this freedom is made subject to a requirement that the dealings be disclosed to the Stock Exchange, the Panel and the press. The methods and details of the required disclosures are elaborated in Practice Note 7.

### 3. Recent insider trading cases

The Panel and its Executive have consistently maintained that the incidence of insider trading is exaggerated, particularly by the press. Nevertheless the Panel has considered a number of cases of alleged insider trading with varying degrees of success. There has been a conscious attempt to avoid the creation of a precedent system, so the Panel’s published statements of these cases are not necessarily authoritative as to future cases.

One of the first cases that the Panel had to deal with in the context of insider trading was that of *Norbury Insulation* [46]. *Norbury Insulation*, which was controlled by Woods, made a bid for *Hayeshaw Ltd.* Previous to the public announcement, *Wiltshire Investments* (which held the investments of a number of overseas family trusts of which Woods was the settlor and principal beneficiary) made a series of significant purchases through the Earl of *Norbury*, a stock broker. When *Norbury Insulation* subsequently realized that *Hayeshaw’s* earnings were not up to their expectations, the company sought to withdraw the bid; Woods, through Lord *Norbury* managed to “off load” a considerable amount of stock. However, when the Panel refused permission to withdraw the bid, Lord *Norbury* started purchasing again on behalf of Woods.

The Earl’s contention that this trading had occurred as a result of his own discretion in managing the trust funds was rejected by the Panel. Woods and the Earl then claimed that they had been unaware of the requirements of the Code and had violated Rules 30 and 31 in ignorance. The Panel also rejected these claims. Furthermore, the Panel observed that despite the precise rules in the Code the transactions were of such a nature “that according to the ordinary canons of propriety, they ought never to have been undertaken”.

As a result of this investigation, the Stock Exchange Council banned the Earl from dealing for six months and censured four of his partners. The Panel censured Woods and pressured him to resign from his position as director of Norbury. (Woods was reappointed to the board a year later.)

In *D.F. Lyons and Co. Ltd.* [47], the Panel considered the application of insider trading rules to non-offeror third parties. D.F. Lyons was a private company conducting business as an investment banker. Over a period of time the company and its associates had been acquiring the securities of Rowan and Boden Ltd. Their acquisitions were of such an amount as to bring them within the provisions of the Code that require a general offer to be made to all shareholders [48]. The controllers of D.F. Lyons persistently kept delaying this. The Chairman of D.F. Lyons approached stockbrokers, Simon and Coates, and apparently instructed them to find a purchaser for the relevant securities who would be willing to make a general offer. The Panel accepted that, although the *offeror* is generally entitled to indulge in market transactions unhampered by Rule 30, the position is otherwise where the offeror is privy to confidential information including the intentions of a third party. The Panel stated,

So far as his [Lyons'] offer was concerned there was no ban on market dealings. The offer, to the preliminary discussions or intentions of which he was privy, was an offer by a third party, which offer, although at the same figure as his own, might in the event be preferred by the market – as indeed it was.

Thus when the Lyons company went into the market to acquire securities after this date, they were in violation of Rule 30 since they dealt with knowledge of a possible offer by a third party. The Panel repeated its observation in the earlier case, “It is axiomatic in the City, that inside information must never be used for personal gain”. The Panel stated that it was not necessary for them to decide whether the disclosure of the plans to the market would have had a substantial impact on the market price, or indeed whether anyone was damnified by the conduct of D.F. Lyons, as Rule 30 contained an outright and absolute prohibition. The Panel severely censured Mr. Lyons, who was the controller of D.F. Lyons, for his conduct in the present case. In fact the Panel stated that it was their considered opinion that “it would be contrary to the public interest for Mr. Lyons or his company to be given a license to deal in securities” [49]. The Panel sent a copy of the Statement to the Department of Trade [50].

Further violations of Rule 30 were exposed in the case of *P.R. Grimshawe and Co.* [51]. This company held 20% of the shares of Grimshawe-Windsor. It was decided that the two companies should merge, by Grimshawe-Windsor making an offer for the outstanding securities of P.R. Grimshawe and Co. To avoid the rule against acquiring one's own shares, the offeree company decided to allow its 20% holding in the offeror to be privately placed. However, about an eighth of these securities were taken up by insiders of the offeree, who were well aware not only of the impending merger but also of the effect this would have, when announced, on

the price of the company's shares. The Panel "ordered" the insiders concerned to repay their profits to the company, with the amount being fixed at the difference between the placing price and the average market price during the first four days of dealing after the end of the Stock Exchange's suspension, less the cost which would have been incurred in selling the shares (a sum of £ 47,000). The profit was paid back not by the insiders but by the merchant bank that had advised the parties concerned, since the bank thought that it might appear that it had been inadvertent. The insiders thus remained untouched and the deterrent effect of the Panel's Statement was frustrated.

The development of a stricter approach to insider trading by the Panel as well as by the Appeal Committee was shown in the case of *Mount Charlotte Investment Ltd. and Gale Lister and Co. Ltd.* [52]. Despite this stricter approach, however, the outcome of this case raised questions about the Panel's effectiveness. The boards of the two companies announced agreed terms for a merger and issued a joint statement that P.R. Grimshawe had sold 200,000 Gale Lister securities for his own account without the prior knowledge of the board of Gale Lister. The problem was that P.R. Grimshawe was the financial adviser to Gale Lister and had publicly promised support for the bid. Referring to General Principles 1 and 3 of the Code, the Panel expressed the view that a financial adviser should not deal with his securities differently from the way he had advised the shareholders. The question was whether P.R. Grimshawe (and in particular Peter Grimshawe, the managing director), had behaved improperly in this respect. The Panel Executive made considerable efforts to interview Mr. Grimshawe; in the end Grimshawe made a written reply, in which he argued that the only rule that he could remotely be accused of violating was Rule 31 (involving merely notices of trading to the Stock Exchange, the Panel and the press). Grimshawe had argued that there was a difference between committing its clients' funds to a particular course as a merchant bank, and the commitment of its own funds, and referred to the "Chinese Wall" concept. The Panel rejected this, although endorsing the principle of segregation. In the result the Panel decided that both Grimshawe and his bank were deserving of "grave censure". The Appeal Committee affirmed the decision of the Panel. It is not without interest that before the Appeal Committee representatives of the merchant bank emphasized that Peter Grimshawe had been removed from all executive functions in the bank, and a solicitor appeared to state that attempts were being made to unseat Grimshawe from his directorships. In view of this, and the fact that the bank had been unaware of the transactions, the Appeal Committee thought that the question of the bank's license should not be specifically referred to the Department of Trade. However, the Panel's Statement was sent to the Department and the question of Peter Grimshawe's license and those of his companies was referred to the Department [53].

The aftermath of the Panel's action raises questions about its effectiveness in this case and points up the potential for public controversy. Within a month of Grimshawe's dismissal as chairman [54], he issued a public statement asserting that there

had been “damaging and misleading statements made about him” which he strongly objected to. He argued that his “personal position” had not been considered by the Appeal Committee, and he had “suffered the Panel’s censure for an offense against the general principles of the Code” (apparently meaning “only” against the general principles). He added that,

I feel they have been unduly severe in the personal nature of the sentence. I am taking action such as is available to me to clear my name [55].

The Department of Trade intimated to Grimshawe that they were seriously considering refusing to renew his license as a dealer in securities. However, on appeal to a Special Tribunal set up by the Department of Trade to hear such cases he was exonerated and it was recommended that his license be renewed, which in fact it was [56].

At the same time Mr. Stephen Watling, who had been a director of Gale Lister, made a public statement that it had been he who had suggested to Mr. Grimshawe that the shares be sold. Simultaneously Grimshawe made another statement to the effect that he had been unsuccessful in persuading the Appeal Committee to reopen his case. He added that the Department of Trade’s Special Tribunal “had agreed that the Appeal Committee hearing was not an effective appeal”. Mr. Watling added that the Panel had refused to hear him or consider his statement and that thus their decision had been “unjustified and unfair” [57]. It is not without the greatest interest that Mr. Grimshawe, after all this, stated in the Financial Times that

I am, however, satisfied that I have now cleared my name. So far as I am concerned the matter is now closed and I can get on with the new businesses in which I am interested [58].

Hardly an attestation to the Panel’s effectiveness! Within 13 months Mr. Grimshawe was, *inter alia*, Chairman of the Pennine Motor Group.

In the *House of Fraser* take-over, the Panel was less successful even in establishing that improper insider trading had occurred [59]. The Panel requested the Stock Exchange to carry out an investigation into dealings in the shares of the House of Fraser that had taken place prior to a public announcement of a take-over offer [60]. The investigation showed that there were a number of transactions which appeared to be significant, including purchases by a director, a personal assistant, and other employees of the House of Fraser.

Among other transactions examined were those of Sir Hugh Fraser and his family trusts. As these were sale transactions, and thus presumably against the impact of the public announcement, the Panel stated,

[A]lthough constituting a technical breach of Rule 30 . . . the Panel considered that these dealings . . . were not significant in the context of the enquiry.

This approach has been criticized on the ground that it appears over-generous and understanding to the "big names" in the City and industry.

The Panel concluded that the offeror "had maintained complete security throughout the negotiations" but in view of the close connection between the company and many of the purchasers, it was unable to reach the same conclusion with regard to the House of Fraser. Whilst it was not possible to identify the source of the leak positively, it appeared certain that there had in fact been a leak, although the identity of the potential offeror might not have been known [61]. The Panel emphasized that

... there is not sufficient evidence to suggest that anyone was guilty of insider trading as defined in the Code, but there are strong grounds for concluding that the House of Fraser did not adequately observe the strict requirements of Rule 7 of the Code which stresses the need for complete secrecy during bid negotiations [62].

The Panel added that it considered open to question

... the propriety of dealings by directors or close associates of directors of a company in the shares of the company at a time when it is known that the Chairman is seeking a purchaser for his holdings and that negotiations affecting the future of the company may take place ... [63].

In *Dexion-Comino International Ltd.*, the Panel found that insider knowledge of the accuracy of a publicized rumor was sufficient to violate the Code [64]. The Stock Exchange conducted an investigation into dealings immediately preceding the announcement of an agreed bid between Dexion and Interlake Inc. and passed the findings on to the Panel. The investigation found that three days before the public announcement, Mr. J.S. McKerchar, a Magistrate and man of some standing in the City, visited Kleinwort Benson Ltd. (Dexion's merchant bank), to discuss the suggestion that he become a director of the company. He was informed that the position had changed because Dexion had received an offer. He was given no other details, but the communication was made in such circumstances that, as McKerchar admitted, there was a clear duty of confidentiality. Later on that day, he sought information from his brokers as to the market in Dexion's securities. He was informed that the market was fluctuating, since there were rumors that a public offer was about to be made. Without giving the brokers any information, McKerchar instructed them to buy for his own account 20,000 ordinary shares in Dexion, to hold them for a week, and then to sell out. The brokers complied with this; in fact the shares were sold at a substantial profit three days after the public announcement.

On returning from holiday, McKerchar discovered that the Panel and the Stock Exchange were making investigations. He wrote to Kleinwort Benson Ltd., explaining the circumstances of the transaction and claiming that in view of the sharp rise in the price of the securities he had thought that the likelihood of the offer was public knowledge. Given his mistake he promised that his profit would be given to

charity [65]. The Panel thought that there had been a clear violation of Rule 30:

[E]ven if there were rumours that a bid was to be made, Mr. McKerchar knew that the rumours were in fact true. He was thus an insider, in a better position than other investors who had at most heard rumours.

The Stock Exchange investigation committee's report stated that "some of those who dealt may have had advance information of a privileged nature" [66].

The Panel was influenced by the fact that when McKerchar entered into the transaction he did so "without giving serious thought at the time to the grave implications under the City Code". Furthermore, he was a man of proven integrity and had come forward on hearing about the investigation. Thus the Panel merely reprimanded him and endorsed his donation of £ 2,000 to a charity approved by the Panel. Although giving "careful and sympathetic consideration" to McKerchar's position, the Appeal Committee affirmed the decision of the Panel that the facts of the case should be made publicly known [67].

The obligation of a tippee to act in accordance with the Code was examined by the Panel with respect to the public offer by Hewden-Stuart Plant Ltd. for *A. Gunn (Holdings) Ltd.* [68]. Here again both the Panel and the Stock Exchange had initiated investigations because of dramatic price rises just prior to the announcement of a public offer. It appeared that on the afternoon of Sunday, June 8, 1976, certain directors of *A. Gunn (Holdings) Ltd.* were meeting to discuss the proposed merger, which had not yet been announced. Mr. D.M. Gunn, the joint managing director, was due at a wedding later that afternoon. When it became apparent that he would have to forego attending the ceremony, and attend only the reception, he telephoned his host, Mr. S.S. Ordman, to inform him of this. By way of explanation Gunn added that "he was involved in merger discussions". That evening Ordman ordered his stockbroker, who was present at the reception, to acquire £ 5,000 worth of Gunn shares on his account. The Panel stated that whilst they could sympathize with Mr. Gunn's desire to explain and justify his forced absence from the ceremony, he had nonetheless behaved "indiscreetly" and was deserving of a reprimand for failing to observe Rule 7. The Panel added,

[A]lthough Mr. Ordman was not in any way connected with Gunn or the proposed offer for Gunn and therefore could not be said to fall within the provisions of Rule 30, the Panel considers that he knew or ought to have known that he received the information in confidence and that it was not to be acted upon.

Thus the Panel stated its disapproval, although Mr. Ordman retained his £ 1,100 profit.

The full force of the Panel's authority was seen in the recent case of *Ultra Electronic Holdings Ltd.* [69], where the Panel and Appeal Committee severely censured a director of an investment company who had engaged in personal dealings on the basis of knowledge that a bid was imminent for a company in which his

company was a substantial shareholder. In addition the Panel "ordered" him to pay his profit of £ 7,000 to an approved charity. Similarly, in the case of *C.H. Johnson and Sons Ltd.* [70] an employee of a bank, which was involved in the negotiations for a public offer, traded through a nominee on the basis of inside information. The Panel named the individual concerned, who lost his job, and "ordered" him to pay his profit to a charity. It should be noted that the employee had co-operated fully with the Panel in this case.

In *J.B. Eastwood Ltd.* [71], a director of Eastwood learned that an American corporation was interested in making a very favorable offer for Eastwood. The director placed an order with his broker for 10,000 shares in his company in the name of his wife. He notified the company after this order had been executed. Eastwood had adopted the Stock Exchange's Model Code on Directors Dealings [72] and thus his conduct was clearly in breach of the rules that this Code prescribes. First, he should not have dealt on the basis, or at least whilst in possession, of inside information. Second, he should not have dealt during a period of two months immediately preceding the preliminary announcement of the company's annual results; this he had done by placing his order when he did. Third, he should have notified the chairman of his company before he dealt. It is interesting that as soon as Eastwood's chairman became aware of the facts an internal investigation was instituted with the assistance of the company's merchant bank. The director resigned his directorship and left the employment of the company. The Panel in its statement identified him and publicly censured him for his breach of Rule 30 and the Stock Exchange's Model Code. The director publicly expressed his regret and volunteered to surrender his profit to a charity.

Yet another illustration of the Panel's ability to deal more or less effectively with insider dealing is shown in the Panel's statement on *Chaddesley Investments Ltd.* [73]. In a strongly worded statement, the Panel found that a director of the Schlesinger Group had violated the spirit if not the letter of Rule 30. It appears that the director advised a South African client of Schlesinger to purchase shares in Chaddesley Investments on the basis of privileged information. A substantial shareholder of Chaddesley had been approached by another company with the intention of acquiring its holding in Chaddesley. The director in question had been appointed agent of the substantial shareholder for the purpose of negotiating this transaction. It should be noted that the director was closely associated with Chaddesley, as one of Schlesinger's subsidiaries held about sixteen percent of Chaddesley's shares, and in addition managed the group's property portfolio. The director argued that, at the time he advised his client to acquire shares in Chaddesley, there was no definite or firm offer in existence and thus there was no "bid" within the terms of Rule 30. The Panel stated,

The Panel finds it difficult to accept such a contention in the circumstances. It is true that the Rule does not refer specifically to the sale of shares which may lead to a mandatory offer, that it forbids the release of information relating to the potential offer, rather than specifically for-

bidding the giving of advice based on that information, and that it contemplates the insider himself dealing in the shares. The Rule, like the rest of the Code, is not expressed in precise detailed language, it is expressly stated and has been repeatedly emphasised that the spirit of the Code must be observed, as [the director] has acknowledged . . . Rule 30 is specifically concerned with an insider dealing in shares, but it cannot be accepted . . . that an insider escapes criticism if he advises someone else to deal.

The Panel also noted that at the relevant time “Schlesingers had failed to separate corporate finance functions from investment advisory functions”, and welcomed the fact that Schlesinger had now introduced internal arrangements designed to prevent a repetition of this. Whilst the Panel accepted that the transaction involved no personal gain for the director it felt it necessary to “record its strong disapproval of the action which” he had taken.

Where the participants in the transaction are outside the Panel’s jurisdiction understandably there have been problems. However, the Panel’s statement on *Sime Darby Holdings Ltd.* does show the determination of the Panel to uncover insider trading abuses, even though the transactions might have occurred abroad [74]. In this case the Panel severely censured two named persons for insider trading and expressed the view that one was unfitted to be a director of a public company. In addition the Panel criticized a director of a leading merchant bank for allegedly turning a blind eye to probable violations of the Code [75]. A recent case where the Panel was unable to deal effectively with a case of insider trading involving persons outside its jurisdiction is that of *Dunford and Elliott Ltd.* [76]. The share price of Dunford and Elliott’s ordinary shares moved upwards significantly, just before the public announcement that talks were taking place with another company which might lead to an offer being made for Dunford and Elliott’s shares. At the request of the Panel the Stock Exchange investigated dealings in the issuer during the relevant period. It was found that 105,000 shares had been purchased by three Swiss banks. It is perhaps worth reproducing here the Panel’s comments on this:

In correspondence which has taken place over many months the Panel executive has been told by each of the banks concerned that Swiss banking laws prevent them from disclosing to third-parties the identity of their clients without the clients’ permission. At the request of the Panel the banks sought the permission of their clients for their identities to be disclosed to the Panel, but in each case the clients had refused to grant their permission. The banks have thus had no alternative but to decline to name their clients. They have, however, all confirmed that the clients for whom these shares were purchased are not residents of the United Kingdom. This case provides a particularly stark example of one of the problems encountered in the course of share dealing investigation.

The Panel and Stock Exchange are not, of course, the only regulatory authorities in this field that have been faced with the practical problem of Swiss banking secrecy and indeed foreign nominee accounts [77]. This is a problem that does not admit of an easy answer for any kind of authority whether possessed of legal powers of investigation or not [78].



There have been a number of other cases where allegations of insider trading have been made. Violations of Rule 30 have been found in some, while in others the Panel has made a number of investigations in which it has found no evidence of insider trading by identifiable individuals even though there appeared to have been a leakage of price-sensitive information to outsiders [79].

#### 4. The effectiveness of the Panel

From the sample of the Panel's cases discussed above it is possible to make some evaluation of the effectiveness of the sanctions available. The most important sanction is that of disclosure and the public disgrace that may be attendant thereupon. Disclosure as a sanction can be a rather blunt instrument and it is impossible to estimate with any degree of precision its ultimate effect. In other cases disclosure may be a two-edged sword. Where the person who is the object of the criticism is in a position to launch a counter-disclosure campaign, as has been done in a number of recent cases, the regulatory effects of the initial disclosure may be negated. Indeed, public opinion may be turned against the regulatory authority making the initial disclosure. Regulatory authorities such as the Panel have only limited resources and are hardly well placed to engage in a public controversy through the mass media. Disclosure in this context is purely a punitive sanction and may only indirectly benefit the market.

The threat of public censure or some other form of sanction has been used by the Panel to persuade some traders to pay to charities the profits they have made through share transactions. Whilst a commendable sanction, there are certain objections to it in practice. First there is the tax advantage enjoyed by those making charitable gifts. Second there is a degree of public esteem that attaches to those who make such gifts. Finally this sanction in no way helps those investors who may have been injured by the violation of the Code.

In many cases the Panel has been willing to refer cases to its constituent self-regulatory authorities for action. Certainly today the Panel can legitimately expect close co-operation from these and other associated bodies, although this has not always been so. The sanctions applied by these bodies are of a professional disciplinary nature and are confined to persons owing professional allegiance to them. On rare occasions the Panel has also referred cases to the Department of Trade, usually in connection with the suitability of a person to hold or be given a license to deal in securities under the Prevention of Fraud (Investments) Act 1958. Although there are cases where the department has appointed inspectors *inter alia* on the recommendation of the Panel, it is open to question how much support it has actually given the Panel.

Listed companies have had their quotation suspended by the Stock Exchange on a number of occasions. The Panel and the Stock Exchange have publicly asserted that this expedient will be used more commonly in the context of take-over opera-

tions and announcements of price-sensitive information. Although in many instances a suspension has been imposed at the request of a company itself, a suspension or a threat of suspension can also be used as a sanction in certain instances. It is hard to envisage the circumstances justifying a delisting, although this too is a possible sanction.

## 5. Market surveillance and investigation

The City Panel on Take-overs and Mergers does not operate a market surveillance program directed towards the detection of insider trading. Where a take-over bid is pending the Panel will instruct the participants and their advisers to keep an eye on the stock market [80], and of course the press will be alert to suspicious dealings [81]. Where there is an allegation of improper trading or where the Panel itself becomes suspicious the Executive might check the relevant prices, but this is the extent of organized surveillance from the Panel's end.

The Stock Exchange does operate a market surveillance program, but it is rudimentary. Indeed before 1974 scant if any attention was given to market surveillance, as it is understood with regard to anti-insider trading regulation [82]. The present author was informed by the Stock Exchange in March, 1975:

[T]he people who carry out the equivalent of the stock watch system here in London work wholly either from our market display system, which shows price movements in 700 leading securities [83], or from material gathered by our Official List Department which compiles the official record which is published daily [84].

Given the traditional jobbing system there is no consolidated transaction tape, as on most developed securities markets throughout the world, and indeed no real possibility of one being devised [85]. In fact, marking of bargains, the basis of the Official Record, is still voluntary. With the current debate on the adequacy of self-regulation there has been a growing awareness in the City that the present scheme of market surveillance is hardly adequate; attempts have recently been made to improve the present procedures.

The Exchange might be alerted to the possibility of improper trading from a number of sources, such as complaints from outsiders and company managements, the Panel, the financial institutions and in particular jobbers and brokers. When suspicious trading is discovered, the normal procedure is to appoint an *ad hoc* investigation committee, composed of some two to four members of the Stock Exchange who serve part-time and without pay. The decision whether to appoint a committee is entirely up to the Exchange, and it is free to choose to investigate complaints through preliminary investigations to determine whether or not a committee is warranted. It must be emphasized that the Stock Exchange is entirely a private institution, under no obligation to carry out investigations.

Until recently investigation committees would never interview members of the

general public and, although co-operation and assistance were expected from those active in the securities industry, direct evidence was generally obtained only from members of the Stock Exchange. Under Rule 15 of the Stock Exchange all members are under an obligation to attend upon the Council and its committees "and give such information as may be in their possession relative to any matter under investigation" [86]. Lists of transactions can thus be obtained from jobbers, and the relevant brokers identified. Of course where nominees are involved both the broker and the Stock Exchange are likely to face considerable problems and in any case much depends upon the memories of the individuals consulted.

Upon completion the committee's report is submitted to the Council of the Stock Exchange and in appropriate cases the Council passes a copy to the City Panel. Where there are suspicious dealings by persons whom the Stock Exchange cannot relate to the company, the Exchange and the Panel may send details of such transactions to the chairmen of the companies involved. Given the fear of possible libel actions, the exposing of brokers to actions by their clients for breach of confidence and the admittedly limited nature of the Stock Exchange's investigatory jurisdiction, the Exchange until recently did not make copies of its reports generally available. Since 1974 the Exchange has sought to take a much tougher line with possible cases of insider trading and has made it clear that its investigations and their results would in future attract a greater degree of publicity. Certainly since 1974 the Stock Exchange has been far more open in announcing the establishment of investigations. However, very few reports have been published [87], and the vast majority of investigations appear to be either inconclusive or to show no identifiable insider activity.

The Panel and Executive are thus dependent upon the ability of the Stock Exchange and its investigation committees to provide a detailed reconstruction of the market and to identify those trading therein [88]. On the basis of the Stock Exchange's report the Executive may invite the relevant stockbroker to bring his client before them or the Panel, but this is done in only a small proportion of cases. The Panel's inquiries have been frustrated by nominees and, in a few cases, lack of co-operation. The Panel has also had to contend with situations almost devoid of rational assessment [89].

Whilst the Panel and the Executive do not object to a person being accompanied by his legal adviser, the Panel does not allow the legal adviser to act as an advocate. Given the high calibre of lawyers on the Panel and in the Executive this must place the lay outsider at a considerable disadvantage in his appearance before the Panel. The Panel has been far less concerned than the Stock Exchange about the laws of libel (although it does maintain a substantial indemnity insurance cover) and has been much more prepared to publicize its findings.

## 6. Adequacy of self-regulation

It is not altogether clear that it would be fair to judge the present structure of self-regulation in the British securities industry by the performance of the City Panel on Take-overs and Mergers. Certainly the Panel has proved to be the best example of working self-regulation in an admittedly difficult area. In dealing with the problem of insider trading the Panel has shown the strengths and weaknesses of the present regulatory scheme. There is a degree of flexibility, but also profound evidentiary problems and few directly calculable sanctions. In fact, both the City Panel and the Stock Exchange have acknowledged the deficiencies of self-regulation in this respect; in a joint statement published in February, 1973, they called for insider trading to be outlawed by legislation and for investigatory and enforcement powers to be vested in the police [90].

Some of the alleged advantages and disadvantages of a self-regulatory structure in general, and occasionally as applied to the British system, can be listed as follows:

### *(A) Advantages of self-regulation*

- (a) The persons concerned with self-regulation are often experts in the area, and indeed are often at the pinnacle of their profession.
- (b) From the standpoint of the taxpayer, an efficient system of self-regulation is inexpensive. Furthermore, it reflects the notion that those who use the market place should contribute to the cost of its maintenance.
- (c) A self-regulatory system can be administered more quickly and flexibly than one that must operate according to legal procedures and technical rules.
- (d) Since the rules are non-legal they can be amended to accommodate developments with a minimum degree of trouble.
- (e) Given the status of self-regulatory norms, it is possible to favor the spirit of the rule over its literal wording.
- (f) The question of motivation can be considered to a far greater extent than where a tribunal is administering laws.
- (g) Legal definitions are not sufficiently flexible to accommodate the variety of situations, such as insider trading, that arise in the area of securities regulation.
- (h) Self-regulation encourages strong professional integrity and discipline within the profession.
- (i) Legal regulation must be content with the bare minimum of acceptable conduct, whereas self-regulatory norms can operate from a higher threshold.
- (j) Self-regulation helps to avoid the "them" and "us" feeling between the regulators and those for whom they are responsible.
- (k) Since the basis of self-regulation is consent, the impact of regulation can be extended beyond legal jurisdiction, particularly to foreigners.
- (l) Self-regulation is better able to take account of general or primary policies and objectives than legal regulation.

- (m) Since self-regulators invariably work on an informal basis they tend to be more prepared to "stick their necks out" and give assistance in situations where a legal agency more directly accountable to a superior would be inhibited.
- (n) People are on the whole more likely to respond to requests than orders.
- (o) In real terms the sanctions of disapproval and damaged reputations which lie in the field of self-regulation are far greater than any legal sanction.

*(B) Disadvantages of self-regulation*

- (a) Self-regulators appear to act as judge and jury in their own cause.
- (b) Since the major sanction available in self-regulation is exclusion of the wrongdoer from securities activities, its effectiveness depends upon the credibility of the threat of exclusion. This in turn depends upon the determination of the regulators and the desire of the regulated to avoid being excluded.
- (c) Since jurisdiction is based upon actual or imputed consent, it is both objectionable and impractical to try to extend it to those who are not among the constituents of the regulator.
- (d) There is a potential for conflict of interest between members of the self-regulatory body and outsiders who deal with such members, despite a certain degree of identity of interest.
- (e) Because the self-regulatory agencies do not generally possess a legal basis they do not possess the legal powers that would enable them to deal with outsiders.
- (f) There is uncertainty as to whether many self-regulatory agencies possess qualified privilege from liability for defamation.
- (g) Self-regulation can be expensive and wasteful because of unnecessary duplication and conflicting approaches.
- (h) Regulators may be appointed because of their social pre-eminence or prestige rather than for their administrative qualities.
- (i) Since the public at large inevitably benefits from public confidence in the securities markets through increased capital investment, it is not necessary that the expense of regulating and maintaining the securities industry be borne only by direct users of the market.
- (j) Given the lack of external accountability and surveillance it is difficult to determine whether there are very few instances of actual abuse or whether the self-regulatory agency is merely inept in detecting and exposing them.
- (k) Because of the fragmentation of authority among self-regulatory agencies, it is difficult for an outsider (or indeed an official regulator at home or abroad) to know with whom to deal. Furthermore, since the self-regulatory agencies are essentially private bodies there is no obligation to co-operate with them even if contact is established.
- (l) The vague jurisdictional basis possessed by the self-regulatory agencies can give rise to serious difficulties if their position is challenged in the courts. Similar problems can arise regarding the application of the rules of natural justice and proper process.

- (m) There are gaps in the self-regulatory network, particularly in the area of new professions and services.
- (n) The present system of self-regulation has been built upon the basis of a centralized or predominant securities market in the City of London. This could be challenged by the development of a more substantial over-the-counter market, particularly along the lines of ARIEL, and by developments within the EEC.
- (o) A primary facet of the self-regulation of the City was the strong social and cultural bond cementing the members (the "old boy" or "old school tie" approach) which has diminished considerably in recent years.
- (p) The vast increase of foreign interests which do not necessarily share the same social or moral ethics as those who have traditionally dealt with the City makes implementation of social pressure sanctions less effective.
- (q) Law is, at least in theory, more certain and predictable than self-regulation; in a climate of fierce international competition more certain legal rules might be preferred, even at the risk of sacrificing "higher ethics".
- (r) Self-regulation does not provide a single authoritative voice capable of calling for the legislation that is necessary to deal with areas where regulation has failed. This is particularly evident in the case of insider trading.
- (s) There is no clear delineation of responsibility among the existing agencies. This tends towards a degree of ignorance about the responsibilities and aims of each body, which in turn leads to criticism of the agencies for their failure to deal with certain matters even though they do not have jurisdiction, authority or expertise with respect to those matters.
- (t) It is questionable how flexible the self-regulators actually are. Although they may well have great expertise in their own function, they may be wholly ignorant of related fields and lack co-ordination with other agencies responsible for particular areas. Indeed, different agencies may come to contradictory decisions.
- (u) Because of a tendency in recent years for securities frauds to stretch across national boundaries, it would be preferable for both foreign and domestic agencies to be able to deal with a central authority in the United Kingdom. The lack of such an authority has created problems in the drafting of EEC legislation.

## 7. The future

A primary consideration running throughout the foregoing arguments is the overriding need to preserve and foster investor confidence in the securities markets [91]. There is a feeling that the performance of the Panel and the Stock Exchange with regard to insider trading has not been an adequate substitute for legal regulation. Stock Exchange investigations lack an obvious factor of objectivity and there is always the danger of allegations of "white-washing". The present author has argued elsewhere for the creation of a statutory Securities Industry Commission,

with legal powers of investigation and regulation, which would incorporate the present self-regulatory authorities as delegates of the Commission [92]. However, it appears that at least in Britain the government is not averse to allowing a modified form of self-regulation to continue [93].

There has been much recent activity in Britain designed to improve the regulation of securities transactions. In October, 1976 the Government set up a Committee of Inquiry under the controversial chairmanship of Sir Harold Wilson to examine the functioning and supervision of the British capital markets. The Secretary of State for Trade has established a joint review committee of officers from the Department of Trade and Bank of England to keep the present system of regulation in the securities industry under constant review. Specific legislation on insider trading has also been promised in the near future [94]. The City has recently made considerable efforts to tighten up its self-regulatory control to avoid the creation of a Securities and Exchange Commission. The efforts of the Panel and Stock Exchange with regard to insider trading have already been discussed. The accountancy profession, after a considerable degree of public criticism, is attempting to reconstitute its self-regulatory authority and improve its own surveillance and disciplinary procedures [95].

Undoubtedly the most dramatic development has been the adoption by the City institutions of the main recommendations made by the Director General of the Take-over Panel's Executive and the Deputy Chief Executive of the Stock Exchange, in their confidential report on the regulation of the British securities industry. This has involved the creation of an entirely new self-regulatory authority called the Council for the Securities Industry (C.S.I.) [96]. The C.S.I. is built around the existing self-regulatory machinery of the Stock Exchange, and in particular the Quotations Department of the Stock Exchange and the Panel on Take-overs and Mergers. The various self-regulatory authorities retain their jurisdiction in their particular areas of competence. The Bank of England, which is the driving force behind the Council, has set out its objects as follows [97]:

- (a) To maintain the highest ethical standards in the conduct of business within the securities industry.
- (b) To keep under constant review the evolution of the securities industry, market practice and related codes of conduct and to scrutinise the effectiveness of existing forms of regulation and the machinery for their administration.
- (c) To maintain arrangements for the investigation of cases of alleged misconduct within the securities industry and breaches of codes of conduct or best practice and to keep these arrangements under review.
- (d) To initiate new policies and codes as necessary concerning activities in the securities industry other than those properly within the domestic province of each individual constituent member.
- (e) To resolve differences on matters of principle between constituent parts of the securities industry.

- (f) To ensure liaison with the European Commission on securities industry matters and the implementation of the E.E.C. Capital Markets Code of Conduct.
- (g) To consider the need for changes in legislation affecting the activities of the securities industry and to examine any proposals for such legislation.

The Council is composed of representatives from the securities industry with a token representation of outside interests [98]. Its secretariat consists of three individuals. The real work of the Council is in the hands of two major committees, namely the Markets Committee and the Panel on Take-overs and Mergers. The Markets Committee is really little more than the old City Working Party, which was responsible for the Code on Take-overs and Mergers. In addition to this responsibility the Committee is concerned with the preparation of other codes of conduct and comments on various matters of interest to the securities industry. The Panel remains unchanged in both its authority and operations. There is a considerable feeling, both inside and outside the City, that the C.S.I. has yet to prove itself. The only visible role it has played during its first year is to publish two statements on the proposed legislation for insider trading. The first merely echoed the general view that it is wrong and that legislation is required; and the second voiced certain objections to the wording of the Government's proposed legislation. Neither document can really be described as significant.

Whilst the present author welcomes the City's attempt to "put its own house in order" by the creation of the C.S.I. there is a very real danger that the entire exercise might with some justification be dismissed by the City's critics as wholly cosmetic. Perhaps even more disturbing is the rather cool reception the Chairman of the Stock Exchange has given to the Government's proposals to deal with insider trading [99]. Even more surprising has been the attack on the City institutions by the Conservative Party for not opposing the present Government's proposals more enthusiastically. It should be remembered that the Conservative Government in 1973 introduced into Parliament provisions which were arguably as far-reaching as the present Government's, if not more so. Now, however, the Conservatives would seem to consider that insider trading should in large measure be left to the City, possibly with some express civil remedy provided through legislation for aggrieved investors. Should insider trading become a crime, albeit only in limited circumstances, it is unlikely to affect substantially the way in which the Panel conducts its affairs and supervision over the securities industry. Arguably, the fact that insider trading has been declared unlawful will strengthen the Panel's hand, but by the same token it could result in people being far less prepared to "come clean". Indeed, this is one of the fears of the Chairman of the Stock Exchange, who, perhaps with justification, considers that investors and professionals will be far less willing to co-operate with the self-regulatory agencies if there is a prospect, albeit extremely remote, that criminal charges might follow. On their own the law enforcement agencies would never be in a position to detect a case of insider trading, let alone investigate it. Without a proper system of market surveillance the self-



regulatory authorities have a difficult enough task in this regard. Thus in the result, it is unlikely that the role of the Panel in the regulation of take-overs and mergers, and in particular insider trading, will alter substantially in the foreseeable future. The Panel has proved itself to be as effective a regulator as any other anywhere else in the world, and it would be an act of sheer folly to undermine this.

## Notes

[1] See generally Jenkins, *The Stock Exchange Story* (Heinemann, 1973); Morgan and Thomas, *The Stock Exchange: Its History and Functions* (Elek Books, 1962); Dugid, *A History of the Stock Exchange* (Grant Richards, 1902). There have been attempts in the past to impose a degree of regulation on brokers and dealers. See Report of the Commissioners Appointed to Look after the Trade of England, 11 House of Commons Journals 593 (November 25, 1696); An Act to Restrain the Number and Ill-practices of Brokers and Stockjobbers, 8 and 9 Wm. 3, c. 32 (1697) and An Act to Prevent the Infamous Art of Stockjobbing, 7 Geo. 2, c. 8 (1733). Reference should also be made to Defoe, *The Villainy of Stock Jobbers Detected and the Causes of the Late Run upon Banks and Bankers Discovered and Considered* (London, 1701).

[2] In close homogeneous societies social pressure is likely to be as effective if not more so against deviations from socially accepted norms and patterns of behavior. See Schwartz, *Social Factors in the Development of Legal Control: A Case Study of Two Israeli Settlements*, 63 Yale L.J. 471 (1954); see also Hughes and Bennion, *Professional Ethics*, Appendix to Towards a Code of Business Ethics (Christian Association of Business Executives, 1972).

[3] But see The United Kingdom in 1980, 1974 The Hudson Report 64–66. A very important factor has been the vast increase in foreign banking and financial houses in the City.

[4] But see Rider and Hew, *The Structure of Regulation and Supervision in the Field of Corporation and Securities Laws in Britain* (hereinafter cited as Structure), No. 2/1977 Revue de la Banque 83, and Rider and Hew, *The Regulation of Corporation and Securities Laws in Britain – The Beginning of the Real Debate* (hereinafter cited as Debate), 19 Mal. L. Rev. 144 (1977).

[5] See generally Stamp and Marley, *Accounting Principles and the City Code, The Case for Reform* (Butterworths, 1970); Spiegelberg, *The City Power Without Accountability* (Bland and Briggs, 1973); Newbould, *Management and Merger Activity* (Guthstead Ltd., 1971); McRae and Cairncross, *Capital City: London as a Financial Centre* (Methuen, 1973); Blanden, *The City Regulations on Mergers and Take-overs*, Readings on Mergers and Take-overs (Samuels ed., Action Trust Society, Elek Books, 1970); Penrose, *Some Aspects of the Development, Criticism and Control of the Take-over Bid Since 1945*, 1964 Jur. Rev. 128; Gower, *Corporate Control: The Battle For the Berkeley*, 68 Harv. L. Rev. 1176 (1955).

[6] Stamp and Marley, *op. cit. supra* n. 5, at 8.

[7] This occurred in October, 1959.

[8] Autumn 1959 Stk. Exch. J. 28.

[9] See Penrose, *op. cit. supra* n. 5; De Montmorency, *Take-over Bids*, 1963 J.B.L. 246, 249.

[10] See panel discussion: *The Techniques of Making and Repelling a Take-over Bid*, Chartered Institute of Secretaries, London, November 24, 1965, discussed in 109 Solicitors' J. 946 (1965).

[11] See Weinberg, *Takeovers and Amalgamations* 257–58, 332–41 (2d ed. 1967).

[12] Among other abuses there was significant evidence of insider trading, see, e.g., *Too Much of a Good Thing*, *The Economist*, May 13, 1967 at 701, and the evidence of Charles Clore to the Jenkins Committee, Minutes of Evidence at 522, 523, 533.

[13] Stock Exchange Council, News Release, July 19, 1967.

[14] The City Code on Take-overs and Mergers. Since the Panel was created there have been four editions of the Code. Unless otherwise indicated, all references to the Code are to the 4th ed., 1976.

[15] The Panel's present constituent institutions are the Accepting Houses Committee, Association of Investment Trust Companies, British Insurance Association, Committee of London Clearing Bankers, Confederation of British Industry, Institute of Chartered Accountants in England and Wales, Issuing Houses Association, National Association of Pension Funds, Stock Exchange and Unit Trust Association.

[16] 1969 Annual Report 4.

[17] See Stamp and Marley, *supra* n. 5 at 31–34; Spiegelberg, *supra* n. 5 at 183–86. On the controversial Pergamon Press Affair, see Davies, *An Affair of the City – A Case Study in the Regulation of Take-overs and Mergers*, 36 Mol. L. Rev. 457 (1973); Briston, *The Unacceptable Face*, Sept. 1973 Accountancy 97; Pennington, *Investigations Under the Companies Acts and the Pergamon Affair*, 118 Solicitors' J. 507 (1974). It should be noted that the Department of Trade and Industry appointed inspectors largely on the request of the Panel. See also Latham, *Take-over: The Facts and the Myths of the G.E.C.–A.E.L. Battle* (Iliffe, 1969).

[18] See, e.g., the Hon. A. Crossland, President of the Board of Trade, 772 House of Commons Debates 89; 773 *id.* 332; Newens, M.P., 779 *id.* 852.

[19] See Stamp and Marley, *op. cit. supra* n. 5, at 40.

[20] On the appellate procedure see 1970 Annual Report 7-8; Statement of Policy, April, 1969; Code 7-8.

[21] "Professional reputation and goodwill are usually the most valuable assets of those who draw their livelihood from the securities markets." Supervision of the Securities Markets, para. 35 (City Capital Markets Committee, Dec. 1974). A former Director General of the Panel's Executive emphasized the importance of this sanction and "moral blackmail" at the London Conference on Insider Trading, Portland Hotel, April 3, 1975; see also Rogers, M.P., 867 House of Commons Debates 1003.

[22] The recognized associations of securities dealers such as the Association of Stock and Share Dealers have similarly altered their rules to give effect to Panel decisions. Letter from Mr. H. Londesborough, Secretary, August 19, 1974.

[23] 1969 Annual Report 11.

[24] See generally Weinberg, *Takeovers and Mergers* (3rd ed., Sweet and Maxwell, 1971); Davies, *Regulation of Take-overs and Mergers* (Sweet and Maxwell, 1976); Moon, *Business Mergers and Take-over Bids* (4th ed., Gee and Sons, 1972); Anisman, *Take-over Bid Legislation in Canada – A Comparative Analysis* (CCH Canadian Ltd., 1974); Gore-Browne on Companies, ch. 29 (Boyle and Sykes, 43rd ed., Jordans); Pennington, *Take-over Bids in the United Kingdom*, 17 Am. J. Comp. L. 159 (1969); Prentice, *Takeover Bids – The City Code on Takeovers and Mergers*, 18 McGill L.J. 385 (1972); Yoran, *Advance Defensive Tactics Against Takeover Bids*, 21 Am. J. Comp. L. 531 (1973); Wooldridge, *Some Defences To Take-over Bids*, (1974) J. B. L. 202.

[25] *But see* Rider, *The Crime of Insider Trading*, (1978) J.B.L. 19, with regard to §13 of the Prevention of Frauds (Investment) Act 1958.

[26] For a discussion of the Government's White Paper, see Rider, *The Conduct of Company Directors*, 128 N.L.J. 27 (1978). Note also the provisions in clauses 12 to 16 of the Companies Bill 1973, discussed by Rider, *An Aspect of the Unacceptable Face of Capitalism*, (1974) *Obiter* 9.

[27] ARIEL is a computer-based securities trading system set up in 1972 by leading merchant banks. See Leach, *ARIEL – Its Purpose and Future*, 34 Investment Analyst 23 (1974); interview with J.H.C. Leach, Dec. 1974, *The Banker* 1522.

[28] See Rider, *The Companies Bill – Insider Trading*, 128 N.L.J. 1236 (1978), and also on the Bill, Rider, *Changes in Company Law – Directors' Duties*, 128 N.L.J. 1116 (1978) and Rider, *Changes in Company Law – Directors' Private Transactions*, 128 N.L.J. 1138 (1978).

[29] However, a director may well come into a "special relationship" with a shareholder creating such a duty, see *Coleman v. Myers*, 1977 (2) N.Z.L.R. 225, 298; Rider, *Percival v. Wright – Per Incuriam?* 40 Mod. L.R. 471 (1977); Rider, *A Special Relationship on the Special Facts*, 41 Mod. L.R. 585 (1978). In closely-held companies the position may also be different; on this see Rider, *Partnership Law and its Impact on Domestic Companies*, 38 Camb. L.J. 148 (1979).

[30] But in exceptional circumstances there may be a duty of disclosure under the Law of Sale; see *Pretorius v. Natal South Sea Investment Trust Ltd.*, 1965 (3) S.A. 410(W) at 418, discussed by Rider, *The Regulation of Insider Trading in the Republic of South Africa*, 94 S.A.L.J. 437 (1977).

[31] Clause 44 of the Companies Bill 1978 seeks to codify the relevant law on this; see Rider, *Changes in Company Law – Directors' Duties*, 128 N.L.J. 1116 (1978); see also Rider, *The Fiduciary in the Frying Pan*, (1978) Conveyancer 114. Of course, a major problem in Britain is mounting a derivative action to recover such profits; as to the recent developments in this field, see Rider, *Amiable Lunatics and the Rule in Foss v. Harbottle*, 37 Camb. L.J. 270 (1978).

[32] See Rider, *The Abuse of Inside Information*, 127 N.L.J. 830 (1977).

[33] For an extensive discussion of the relevant provisions (i.e., §§27 to 31 with regard to the reporting of directors' and their spouses' and childrens' dealings, and §§33 and 34 with regard to substantial shareholders' interests, of the 1967 Companies Act, and also §§24 to 27 of the 1976 Companies Act) see Rider and Ffrench, *The Regulation of Insider Trading* (The Macmillan Press, 1979) at 174–90.

[34] On the role of self-regulation in this field see Rider and Ffrench, *The Regulation of Insider Trading* (The Macmillan Press, 1979) at 160–74 and Chapter 16. It is most interesting to note that the Hong Kong Government has moved away from strict legal regulation of insider trading to a form of regulation very similar to that operated in Britain under the self-regulatory system; on this see Rider, *The Regulation of Insider Trading in Hong Kong*, 17 Mal. L. Rev. 310 (1975), continued in 18 Mal. L. Rev. 157 (1976), and Rider, *Insider Trading – Hong Kong Style*, 128 N.L.J. 897 (1978).

[35] Code at 4.

[36] See Panel on Take-overs and Mergers, 1974 Annual Report 10, where the Panel stated "in particular satisfactory arrangements have been made [with ARIEL] regarding disclosure of dealings and if necessary investigations into dealings where it would appear that there has been a leakage of information".

[37] Code at 5.

[38] See Rule 73, Rules and Regulations of the Stock Exchange.

[39] See Code, General Principles 3, 8 and 9.

[40] This has been reaffirmed in the Joint Statement of the Stock Exchange and the City Panel on Take-overs and Mergers, Announcements of Price Sensitive Matters, April 14, 1977; see also Panel Statement on *Johnson and Firth Brown Ltd./Dunford and Elliot Ltd.*, Dec. 23, 1976; *Dunford and Elliot Ltd. v. Johnson Firth Brown Ltd.*, [1977] 1 Lloyds Rep. 505; Rider, *Abuse of Inside Information*, 127 N.L.J. 830 (1977).

[41] See Code, Practice Note 2.

[42] "[T]he offer should be put forward in the first place to the board of the offeree company or to its advisers." Code, Rule 1.

[43] This is the same as Rule 30 of the 1974 Code, which was substantially similar to the 1972 Code. The 1969 Code was slightly different; it provided in Rule 30:

[N]o dealings of any kind, including option business in the shares of the offeror and offeree companies by any person who is privy to the preliminary take-over or merger discussions or to the intention to make an offer, may take place between the time (a) when the initial approach is made or intimated or (b) when there is reason to suppose that an approach or an

offer will be made and the announcement of the approach or offer, or of the termination of the discussions as the case may be.

The word "person" extends to a company. See 1970 Annual Report at 16.

[44] See Prentice, *op. cit. supra* n. 24, at 410. This is a matter that has caused the Panel some concern; see, e.g., Panel Statement, The Accumulations of Shares Prior to the Making of an Offer, September 18, 1970. The better view in Britain is that mere knowledge of one's own intentions and plans with regard to a particular security cannot be considered inside information, although it could when possessed or utilized by another person.

[45] Code, Practice Note 9.

[46] Panel Statement, April 2, 1971; *The Times*, April 3, 1971; 1971 J.Bus.L. 142.

[47] Panel Statement, October 2, 1972.

[48] By Rule 34 a person who alone or in concert with others acquires in excess of thirty percent of the voting rights of a company must make an offer to all the other shareholders, conditional upon the offeror receiving acceptance in respect of more than fifty percent of the voting rights, on terms equal to the highest price paid with regard to the initial acquisition.

[49] Panel Statement, October 2, 1972, at 5.

[50] See Clarkson and McKinlay, Report of the Department of Trade Inspectors on Edward Wood and Co. Ltd., Skibben Winton Construction Ltd. 75 (H.M.S.O. 1977).

[51] August 1973.

[52] Panel Statements, January 16, 1974 and January 30, 1974; *The Times*, *The Financial Times* and *The Guardian*, January 31, 1974.

[53] Panel Statement, January 30, 1974, at 1; see *The Times*, *The Guardian* and *The Financial Times*, January 31, 1974 and *Investors Chronicle*, February 1, 1974, at 365.

[54] *The Times*, *The Guardian*, *The Financial Times*, January 29, 1974. Mr. Grimshawe also "resigned" under pressure from a number of other companies; see *The Times*, February 12, 1974.

[55] *The Financial Times* and *The Times*, February 1, 1974. For the company's statement denying Mr. Grimshawe's authority and emphasizing the bad position of the company, see *The Times* and *The Guardian*, February 16, 1974.

[56] *The Times*, *The Guardian* and *The Financial Times*, November 23, 1974.

[57] *Id.*

[58] *The Financial Times*, November 23, 1974.

[59] Panel Statement, July 23, 1974.

[60] *The Financial Times* and *The Times*, November 14, 1973.

[61] Panel Statement, July 23, 1974, at 3; see *The Daily Mail*, *The Times* and *The Financial Times*, July 24, 1974.

[62] Panel Statement, July 23, 1974.

[63] Panel Statement, July 23, 1974, at 3.

[64] Panel Statement, April 25, 1975.

[65] Panel Statement, April 25, 1975, at 2.

[66] *The Daily Telegraph* and *The Guardian*, October 18, 1974.

[67] Panel Statement, May 8, 1975.

[68] Panel Statement, February 11, 1976; *The Times*, *The Guardian* and *The Financial Times*, February 12, 1976.

[69] Panel Statements, September 22, 1977 and October 7, 1977.

[70] Panel Statement, November 28, 1977.

[71] Panel Statement, July 20, 1978.

[72] *The Model Code for Securities Transactions by Directors of Listed Companies*, October 1977, discussed in Rider and French, *The Regulation of Insider Trading* (The Macmillan Press, 1979) at 167-69.

[73] Panel Statement, January 19, 1979.

[74] Panel Statement, July 27, 1976. It should be noted that the Singapore authorities co-operated with the Panel in the provision of certain documents.

[75] On the responsibilities of financial advisers to the Panel, see 1977 Annual Report 10.

[76] Panel Statement, May 26, 1978.

[77] *See, generally*, Rider and Ffrench, *The Regulation of Insider Trading* (The Macmillan Press, 1979), Chapter 17.

[78] *See* Rider, *The Companies Bill – Insider Trading*, 128 N.L.J. 1236 (1978) with regard to clause 62 of the Companies Bill 1978, which would empower the Secretary of State to appoint inspectors to investigate suspected cases of insider trading.

[79] *See*, for example, Panel Statements on George Kent Ltd., February 7, 1975; Miles Druce, January 9, 1974; Contractors Services Grays Ltd., Gallaher Ltd., John M. Henderson Ltd., Midland Aluminium Ltd., Peureula Investment Ltd., August 11, 1975; British Steel Corporation and Lye Trading Company Ltd., September 18, 1974; FMC Ltd. and Henry Foster Building Products Ltd., September 30, 1975; Coley-Rotolin Group Ltd., February 14, 1975; The Dickinson Robinson Group Ltd. and Royal Sovereign Group Ltd., June 20, 1977.

[80] *See, e.g.*, *The Guardian*, June 17, 1976.

[81] *See* Manchester Liners, *Investors Chronicle*, August 30, 1974; Bovis, *Investors Chronicle*, December 28, 1973, at 1370; Beyer Peacock, *Investors Chronicle*, June 14, 1974, at 1317; Newman Industries, *Investors Chronicle*, August 16, 1974, at 627.

[82] The Stock Exchange has of course always been concerned to maintain an orderly market but this is somewhat different from the operation of a stock watch program as is done on most North American Stock exchanges.

[83] This information is based upon periodic reports of jobbers' bid and ask prices.

[84] Letter to the author from the Head of the Public Relations Department, March 14, 1975.

[85] Jobbers with some justification consider that it would be impossible to operate in a market where transaction prices were instantaneously made publicly available, since their positions would be undermined.

[86] The Stock Exchange suspended Mr. Ralph Clarke for two years and publicly censured him in April, 1974, for failure to disclose the identity of a client when requested to do so by the Council of the Stock Exchange and the Panel.

[87] *See* Statement by the Special Committee of the Stock Exchange on Scottish and Universal Investments Ltd., November 30, 1976 and Statement on the offer by F.H. Lloyd Ltd., for Colely-Rotolin Group Ltd., Notice, November 4, 1974.

[88] Once insider trading on the Stock Exchange becomes a criminal offense under the provisions contained in the Companies Bill 1978, the same situation will still pertain. Whilst the Bill, in clause 62, makes provision for the appointment of inspectors to investigate suspected offenses under the Act, the Bill is silent on the question of detection. *See* n. 78 *supra*.

[89] In one case the Panel had no alternative but to accept that a chartist was "clairvoyant". The Executive, evidently, decided to "gloss over the whole thing" as the true story seemed to be so improbable that no one would believe it. Fraser, *The Case for the Voluntary System*, 2 J. Bus. Fin. 14, 19 (1974).

[90] *See* Panel Statement on Insider Dealing, February 2, 1973. The Panel has consistently called for legislation in this area; note for example the statement by Lord Shawcross, Chairman of the Panel, at the First Annual Conference of the British Institute of Securities Laws, London Hilton, November 23, 1978, and see 1978 Annual Report 4.

[91] *See* Rider and Ffrench, *Should Insider Trading be Regulated – Some Initial Considerations*, 95 S.A.L.J. 79 (1978) and River and Hew, *Regulação de Títulos de Empresas no Reino Unido – Os Méritos da Auto-Regulação*, (1978) *Revista Brasileira de Mercado de Capitais* 21.

[92] *See supra* at ns. 4 and 91; *see also* Rider, *The Regulation of the British Securities Industry* (Oyez, 1979) Chapter 1; transcripts of The First Annual Conference of the British

Institute of Securities Laws, London Hilton, November 22 and 23, 1978 (B.I.S.L. 1979); The Seminar on Corporate Fraud in the Far East, by the British Institute of Securities Laws, Manila Intercontinental Hotel, January 9, 1979 (B.I.S.L.). *See also*, *A Companies Commission*, Justice, October 1974.

[93] *See* for the various proposals, Rider and Hew, *supra* n. 4.

[94] *See* text *supra* at n. 25 *et seq.*

[95] Note, in particular, Report of the Special Committee under the chairmanship of Lord Cross, which reported in 1977; Report of the Joint Committee appointed to consider the Cross Report and related matters, which reported in May, 1978. *See*, on this, Rider, *The British Council for the Securities Industry*, (1978) *Revue de la Banque* 303, 315.

[96] *See, generally*, Rider, *The British Council for the Securities Industry*, (1978) *Revue de la Banque* 303.

[97] Bank of England, April 1978.

[98] *See* n. 96 *supra*.

[99] *See* Rider and Ffrench, *The Regulation of Insider Trading* (The Macmillan Press, 1979) Chapter 18; and Stock Exchange News Release, September 28, 1978.

### Author's note

The present article was at proof stage during the passage through the House of Commons of the 1978 Companies Bill which *inter alia* would have rendered insider trading a criminal offense. Of course, with the fall of the Labour Government in the Spring of 1979 this Bill failed to pass into law. However, it is known that the present Government is preparing a bill which will seek to outlaw insider trading presumably providing both civil and criminal sanctions. The comments in the present article relating to the 1978 Bill should therefore be viewed in the light of this note.

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